Foreign trade and payments

Foreign trade and current account

External environment

In the spring months of 2003, the external environment of German export companies continued to be impacted by the subdued economic developments and uncertainties surrounding the economic outlook in the economies of major trading partners. Against this background, export expectations of German companies for the following months fell in the second quarter of 2003 to a neutral outlook. In the second quarter seasonally adjusted new foreign orders also weakened over the previous period, which had recorded a slight increase in order activity. Overall, however, seasonally adjusted exports in the second quarter of 2003 were just under 2½% lower than the level of the previous three months.

Breakdown of exports

In the spring of 2003 – statistical information on foreign trade by region and product group is available up to and including May – German exporters reported declining sales primarily in the euro area, but saw these drop in the markets outside of EMU as well. In this context, regional export performance was mainly supported by the cyclical position of the trading partners' economies. Thus, seasonally adjusted goods delivered to the euro area on an average of the months of April and May declined by 3% vis-à-vis the average of the first quarter of 2003, owing to the ongoing economic slowdown there. Moreover, exports of goods to the other EU countries, the demand from which had supported German export performance in the first quarter perceptibly, and to the United States, also fell short of the average level witnessed in the

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.

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first quarter. By contrast, an increase in export demand from the central and eastern European transition countries and the emerging economies in South-East Asia was a positive factor. Sales by German exporters to these countries increased moderately.

In the meantime, exports to the United States in particular are likely to have been dampened by the decline in Germany's price competitiveness which started in spring of last year and usually has a delayed impact on exports. Whereas Germany's price competitiveness, calculated on the basis of deflators of total sales, fell in the last year and a half by nearly 28% vis-à-vis the United States and just under 11% vis-à-vis the other non-EMU countries, it improved slightly (+1%) vis-à-vis the euro area countries. According to practically all relevant economic observers, however, the euro was significantly undervalued at the beginning of 2002. With a view to all of the major trading partners, the longer-term outlook for Germany's international competitiveness can, at the moment, be assessed as approximately neutral.

German exporters' entire range of goods was affected by the weaker export demand (see table on page 43). The ongoing subdued investment activity of major trading partners dampened the export business mainly in the capital goods sector (-4½%), which in the current year again accounted for nearly half of all exports. Exports of goods from the information and communication industry posted the sharpest decline (-8½%), which in the first quarter, had still recorded growth. Export demand for machinery and motor vehicles also declined. Exports of intermediate goods, which make up nearly a third of Germany's export business, fell by 2½%. Furthermore, after having posted marked growth in the two previous quarters, exports of consumer goods dropped by 3%, likely owing to the ongoing tense situation in the labour markets of many trading partners' countries.

Imports of goods

Seasonally adjusted imported goods to Germany weakened in the second quarter by just under 3½%. The reduction in the total value of imports is, however, attributed to an equally sharp drop in prices for imported goods in the same period. In real terms, the level of imported goods thus remained nearly constant. One major reason for the observed decline in import prices is likely to have been the steep fall in imported energy prices (-16%) in the second quarter. In the period under review, the prices for imported crude oil alone dropped by more than a fifth compared to the first quarter. Since import prices have broadly fallen, the stronger euro and the overall muted domestic demand are also likely to have contributed to these price declines. Slight growth was observed only in the areas of motor vehicles and chemical products.

Trend in foreign trade by region and by categories of goods

Seasonally adjusted average of April to May period 2003 vis-à-vis average of January to March period 2003 in %

Item	Exports	Imports
Total	– 2.0	– 3.3
Selected country/group of countries		
Euro-area countries	– 3.0	– 3.0
Other EU countries	– 9.4	– 9.5
United States	– 5.2	– 7.0
Japan	– 0.3	– 3.9
Central and east European countries in transition	+ 2.6	+ 1.5
OPEC countries	– 4.6	+ 2.6
Emerging markets in South-East Asia	+ 1.1	– 7.8
Categories of goods		
Selected main categories		
Intermediate goods	– 2.4	– 2.0
Capital goods	– 4.4	– 5.1
Consumer goods	– 3.0	+ 0.9
Energy sources	.	– 7.0
Selected categories		
Chemicals	– 2.6	+ 3.2
Machinery	– 2.0	– 0.5
Motor vehicles and motor vehicle parts	– 3.0	– 0.7
Information technology	– 8.6	– 8.1

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Breakdown of imports

Compared to the first quarter, products of the foreign chemicals industry were particularly in demand in the two-month period of April-May 2003 (+3% on a monthly average). By contrast, seasonally adjusted imports of machinery and equipment and motor vehicles posted a slight decline (-½% each) over the previous period. Other major sectors experienced declines, in some cases a sharp fall in imports, including information and communication technology which fell more than 8%.

This import trend can especially be seen against the backdrop of weaker demand for imported capital goods observed since the winter months. By contrast, despite the ongoing subdued consumer sentiment imports of consumer goods increased by around 1% even with declining prices.

The drop in imports not only affected individual trading partners. Compared with the first quarter, imports from almost all regions fell (see table above). By comparison, imports from the EU countries which are not participating in European monetary union, from the United States and from the emerging markets in South-East Asia declined significantly. By contrast, imports from the central and east European transition countries increased (+1½%), thus further extending their share of German imports in the period under review, namely to nearly 15%. There was a relatively sharp increase in imports from OPEC countries (+2½%) which was remarkable against the background of markedly declining crude oil prices. This may be due to inventories being replenished in the period under review.

Was the German conversion rate too high at the start of monetary union?

The German economy's persistently sluggish growth has been put down in part to Germany joining monetary union at a conversion rate which was too high. As a result, this is said to have impaired the ability of German companies to compete against the other euro area countries.[1] Measured by a competition indicator based on unit labour costs in the manufacturing sector, which is often used in international comparisons, one does indeed at a first glance draw the conclusion that Germany's competitive situation upon entry into European monetary union was clearly below the long-term average for the period since 1975. In this context, it should be considered that in the last two decades, the unit labour costs in the German manufacturing sector have risen more than in the other sectors, which are also of significance for determining the international competitiveness of Germany's economy.[2] In many partner countries by contrast, the exact opposite trend has been observed, meaning that in the long term, using a competition indicator based on unit labour costs in the manufacturing sector, would, in the case of Germany, lead to considerable interpretation errors. Moreover, wages represent only one cost factor, albeit an important one, that companies have to consider. The Bundesbank therefore uses for its analyses a more broadly defined indicator based on the price and cost index of total sales, which in addition to the (unit) costs of the total domestic value-added created (including services produced in Germany) also takes account of imported goods and services. Measured by this more precise indicator, the competitive position of Germany's economy vis-à-vis the other euro area countries at the start of monetary union approximately equalled the long-term average for the period from 1975. It has improved slightly on the whole since then (see chart on page 45). The theory that Germany joined monetary union at an exchange rate that was overvalued, and, as a result, suffered a worsening of price competitiveness within the euro area, must therefore be rejected. Another argument against the theory of a too high conversion rate is the fact that German exports to the euro area developed very dynamically right up to the beginning of 2001, ie more than two years following the start of monetary union. German exports to these countries did not lose momentum until the major euro area trading partners experienced a downturn in growth which started in 2001.

1 A comprehensive analysis of the competitive situation of the German economy in the euro area is planned for the October 2003 issue of the Monthly Report. — **2** In the November 1998 issue of the Monthly Report, the advantages and disadvantages of the various indicators of international competitiveness have been illustrated in detail.

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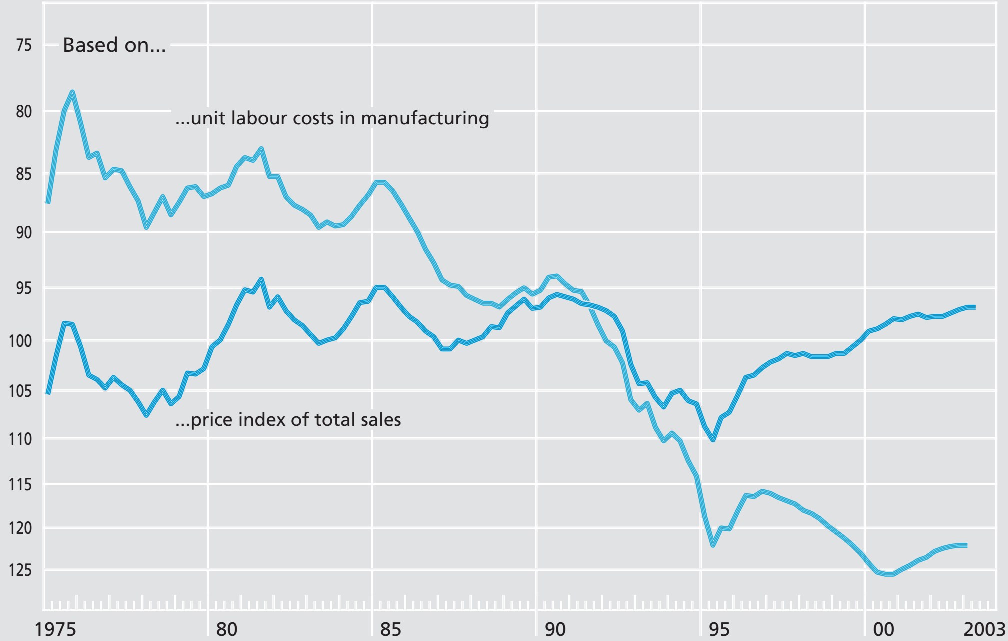
Germany's price competitiveness vis-à-vis the other euro-area countries

Average since 1975 = 100, quarterly average, log scale[1]



1 Scale inverted: rise in curve (fall in values) denotes increase in German competitiveness.

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Current account

Owing to the somewhat steeper decline in imports vis-à-vis exports during the second quarter of 2003, Germany's trade surplus rose in seasonally adjusted terms by just over €½ billion to €30 billion. In the second quarter, the deficit in invisible current account transactions with non-residents rose by €5 billion over the previous three-month period. The deficit on Germany's services account was somewhat higher than in the previous three-month period. Furthermore, net current transfers and (net) payments of factor income to non-residents rose slightly. As a result, the German current account ran a surplus of €6½ billion, compared to approximately €11 billion in the previous quarter.

Financial transactions

Trends in financial transactions

While the rapid end of armed conflict in Iraq at the beginning of the second quarter had, for a short time, given rise to hopes of an economic recovery, renewed uncertainties as to the further development of the global economy led to deflationary concerns, which have, however, recently abated. In parallel to the changing mood on the global markets, significant decreases in the bond yields of first-class borrowers were again recorded well into June. At the end of the quarter, however, they again rose considerably. At the same time, central banks on both sides of the Atlantic used the leeway afforded by the abating price pressure to further cut interest rates, while the euro made considerable ground against other currencies. The exchange rate

Major items of the balance of payments

€ billion

Item	2002 Q2	2003 Q1	2003 Q2
I Current account			
1 Foreign trade 1			
Exports (fob)	162.3	162.8	162.0
Imports (cif)	131.6	133.5	132.2
Balance	+ 30.8	+ 29.3	+ 29.8
2 Services (balance)	– 8.9	– 8.6	– 8.9
3 Factor income (balance)	+ 0.5	– 4.3	– 2.5
4 Current transfers (balance)	– 8.6	– 5.3	– 7.6
Balance on current account 2	+ 12.4	+ 9.7	+ 8.8
Memo item Balances, seasonally adjusted			
1 Foreign trade	+ 30.5	+ 29.3	+ 30.0
2 Services	– 9.4	– 8.4	– 9.3
3 Factor income	– 1.4	– 1.2	– 4.6
4 Current transfers	– 8.7	– 6.8	– 7.7
Current account 2	+ 9.8	+ 11.2	+ 6.7
II Balance of capital transfers 3	– 0.1	+ 0.0	+ 0.2
III Balance of financial account 4	– 20.1	– 15.9	– 29.3
IV Change in the foreign reserves at transaction values (increase: –) 5	+ 2.4	– 1.5	+ 1.5
V Balance of unclassifiable transactions	+ 5.3	+ 7.8	+ 18.8

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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did not weaken until June. This uncertain environment is also reflected in the trend of portfolio flows, which changed direction in the period under review. On the whole, internationally-oriented investors again stepped up their cross-border investment activity which, according to the statistical data so far available, showed that in contrast to the euro area, financial transactions between Germany and non-residents in the second quarter of 2003 resulted in net capital imports through combined portfolio transactions and direct investments, while in the area of credit transactions there were net exports of funds.

Portfolio investment

In the area of portfolio investment, which reacts particularly sensitively to changes in investor preferences and perceptions, net capital imports totalled €7½ billion. However, this figure is clearly lower than in the previous three-month period (€36 billion).

German investment in foreign securities

This development was mainly due to the fact that following the end of the military conflict in Iraq, German savers apparently overcame their strong reluctance to invest abroad once again and increased their securities holdings by €20 billion. In the previous three-month period they sold €5½ billion in foreign securities against the backdrop of the weak global economy and the imminent war in the Middle East. German investors' renewed interest in global investment opportunities especially buoyed sales of foreign bonds, in particular euro-denominated bonds issued by non-residents (€13½ billion). Since these offer a somewhat higher yield than comparable Bunds, they have enjoyed widespread popularity since the beginning of European monetary union. Over the course of the quarter, German investors also geared their portfolios more towards shares of foreign companies. While April still saw net sales of equities, as was the case in the first three months, the waning uncertainty in the financial markets led German investors to becoming net buyers in the second quarter. As a result, their equity holdings actually increased slightly on balance (€½ billion). By contrast, they sold €1½ billion in foreign money market paper.

Foreign investment in German securities

In the second quarter, non-resident investors again showed keen interest in German securities and increased their holdings by €27½ billion on balance (compared to €30½ billion in the previous quarter). In the period under review they focused on bank debt securities (€13 billion, following €8 billion in the previous period), whose spread over public bonds dwindled to 20 basis points by the end of the quarter. Foreign investors did, however, show robust demand for public bonds and notes as well (€12 billion). Investments in longer-term interest-bearing paper were presumably a reflex reaction to the widespread deflation debate, which had led to a rise in the prices of longer-term bonds. German dividend-bearing paper also aroused interest in the second quarter (2½ billion) after investors had sold 2½ billion worth of holdings in this paper in the first three months. The rally on the German stock exchange has certainly contributed to this reversal in investor behaviour. With the DAX rising by more than 30% in the second quarter, they managed to recoup a part of their earlier losses. By contrast, foreign savers purchased only small amounts (€½ billion) of money market paper, ie debt instrument with

Financial transactions

€ billion, net capital exports: –

Item	2002 Q2	2003 Q1	2003 Q2
1 Direct investment	+ 12.3	– 7.6	+ 21.8
German investment abroad	– 2.7	– 16.0	+ 12.7
Foreign investment in Germany	+ 15.0	+ 8.5	+ 9.1
2 Portfolio investment	+ 21.6	+ 36.1	+ 7.4
German investment abroad	– 18.9	+ 5.6	– 20.1
Shares	+ 1.1	+ 14.7	– 0.7
Investment fund certificates	– 1.0	– 3.1	– 0.1
Bonds and notes	– 17.8	– 9.6	– 21.0
Money market paper	– 1.3	+ 3.6	+ 1.7
Foreign investment in Germany	+ 40.5	+ 30.6	+ 27.5
Shares	+ 9.7	– 2.6	+ 2.3
Investment fund certificates	– 1.0	– 0.9	– 0.1
Bonds and notes	+ 25.7	+ 22.7	+ 24.8
Money market paper	+ 6.1	+ 11.4	+ 0.4
3 Financial derivatives 1	+ 1.2	+ 2.9	– 2.0
4 Credit transactions	– 54.7	– 46.8	– 55.8
Credit institutions	– 48.6	– 33.0	– 67.0
Long-term	– 3.2	– 14.6	– 8.2
Short-term	– 45.4	– 18.4	– 58.9
Enterprises and individuals	– 7.7	– 20.0	– 10.5
Long-term	+ 0.1	– 6.8	+ 0.1
Short-term	– 7.8	– 13.2	– 10.7
General government	+ 2.3	+ 1.3	+ 1.1
Long-term	– 0.0	+ 3.7	– 0.1
Short-term	+ 2.3	– 2.5	+ 1.3
Bundesbank	– 0.7	+ 4.9	+ 20.6
5 Other investment	– 0.4	– 0.6	– 0.6
6 Balance of all statistically recorded capital flows	– 20.1	– 15.9	– 29.3
Memo item Change in the foreign reserves at transaction values (increase: –) 2	+ 2.4	– 1.5	+ 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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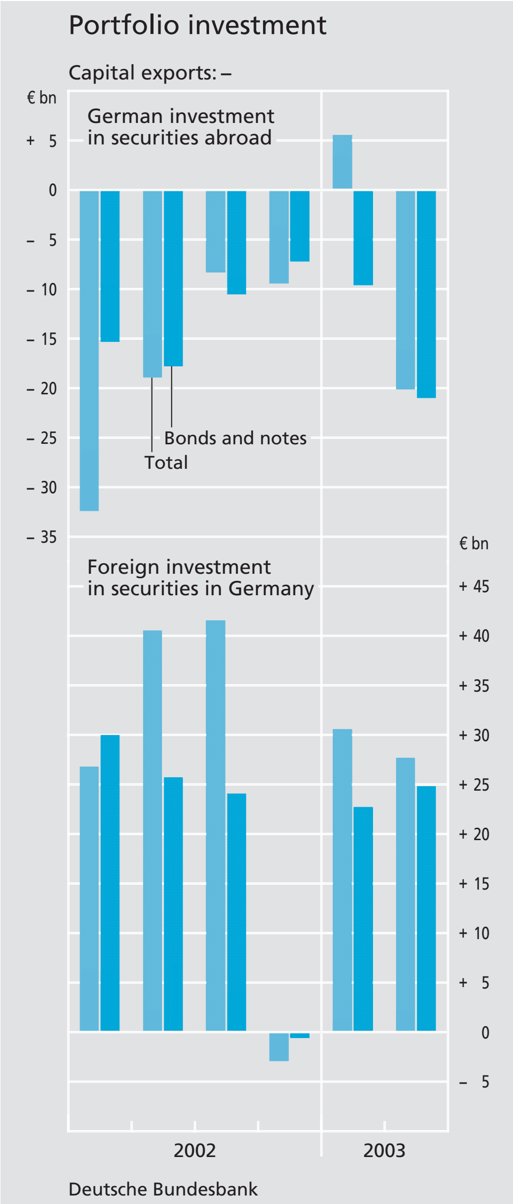

a maturity of up to one year, which had played a major role in the previous months due to their safety and liquidity, while the amounts they invested in investment fund certificates remained practically unchanged.

Direct investment

In line with last year's trend, direct investments in the period from April to June once again resulted in net capital imports (€22 billion), after having witnessed net capital exports of €7½ billion in the previous quarter. The continued dampened economic outlook outside of Germany apparently impacted the direct investment activity of some internationally operating companies as well.

German foreign direct investment

This clearly affected German companies' foreign transactions: in the period under review they repatriated €12½ billion from their subsidiaries. In this context, short-term loans (reverse flows), which subsidiaries granted to their German parent companies, once again played the decisive role. In this context, various financing companies in the Netherlands were of particular importance, which possibly took advantage of the current favourable financing conditions in order to raise capital by issuing bonds and, likely with a view to tax issues, provided these funds to their German parent companies. By contrast, movements in capital equity were relatively limited.

Foreign direct investment in Germany

The negative global economic conditions have had a less pronounced effect so far on foreign companies' direct investment activity in Germany. Foreign proprietors thus increased their direct investments in Germany by an additional €9 billion, after having provided their German branches with fresh funds totalling €8½ billion in the previous quarter. These capital inflows comprised mainly short-term loans to subsidiaries domiciled in Germany.

Credit transactions of non-banks

In contrast to direct investments and portfolio investments, non-banks' unsecuritised credit transactions in the second quarter led to net capital exports (€9½ billion). Enterprises and individuals transferred funds totalling

€10½ billion net abroad in part by significantly increasing their holdings at foreign banks with proceeds from the sale of securities. The operations of public authorities by contrast resulted in a slight net inflow of capital (€1 billion).

Credit transactions of the banking sector

Overall transactions of the banking sector, which can be considered a reflection of the other foreign payments recorded in the balance of payments, recorded net capital exports totalling €46½ billion in the April to June period. The resulting net capital exports were mainly due to an increase of short-term loans by German credit institutions to foreign borrowers (€59 billion), while the net external position of the Bundesbank – excluding the foreign reserves – fell by €20½ billion. This is primarily due to a reduction in claims which had arisen in connection with the gross settlement payment system, TARGET.

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 €1½ billion at transaction values between the end of March and the end of June. Valued at market prices, they fell by nearly €4 billion from €82½ billion at the end of March to €78½ billion at the end of the first half of the year. A slight decline in the market value of gold in euro terms and, in particular, a significant depreciation of the US dollar against the euro, contributed to this development.