Foreign trade and payments

Foreign trade and current account

External environment

In the fourth quarter of 2003, German foreign trade was subject to various, sometimes countervailing, influences. The mood among exporters was one of growing optimism as the upturn in the global economy, which became increasingly apparent in the course of 2003, particularly in the second half of the year, also boosted the German economy. However, the strengthening of the euro also seemed to make itself felt – whether as price concessions granted by German exporters to their customers outside the euro area or as losses of market shares owing to the fiercer price competition. While it is true that Germany's competitive position – for example, against 19 industrial countries on the basis of the deflator of total sales – is still slightly up on its long-term average, the considerable appreciation of the euro – more than 20% since the second quarter of 2002 – means that a (temporary) competitive advantage has undoubtedly been lost, which will tend to make export business more difficult.

Consequently, seasonally adjusted German exports of goods fell in the fourth quarter of 2003 by just over ½% compared with the – very good – comparable figure from the preceding quarter. However, the fact that this does not fundamentally call into question the prospects of a further recovery in foreign business, which are based, above all, on the considerable upward trend in global economic growth, is demonstrated by the sharp improvement in the leading indicators. For example, industry's export expectations as recorded by the Ifo institute soared in October and the estimation remained comparatively favourable up to the end of the period under review. New orders received from abroad supported these positive expectations; in the fourth quarter they were up by 3½% in real terms on the corresponding third-quarter figures.

Breakdown of exports

It is not possible to draw any definite conclusions from the breakdown of exports about the possible implications of exchange rate changes on the recent export developments. A comparison of an average of October and November – statistics on foreign trade by region and sector are not yet available for December – with the third quarter of last year shows that German exporters managed to increase their deliveries mainly within the euro area. Deliveries to other euro-area countries, which at 43% account for almost half of Germany's total exports, rose by 2½%. German suppliers probably benefited from the improvement in the economy in the euro area and their good price competitiveness vis-à-vis competitors in other euro-area countries. By contrast, the turnover in exports to countries outside the euro area fell by 4½% in the period under review. Exports to the central and east European countries in transition, the second most important sales area for German goods after the European Union, went down by as much as 7½%. The fact that the euro also appreciated significantly against some central and east European currencies in 2003 possibly made itself felt here. However, another possible explanation may be the rather random fluctuations in delivery patterns, which can play a significant role in the two-month-average breakdown by country under consideration here. This also applies to the decline

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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in exports of goods to developing countries (-6%) and to China (-10½%). The fact that the aforementioned deterioration in price competitiveness is only one aspect also becomes clear when one considers the example of exports to the United States and the emerging markets in South-East Asia. Although sales of German goods to these countries also went down in the period under review, the decline was relatively moderate. Evidently,

Trend in foreign trade by region and by category of goods

Average of October and November 2003 compared with the average of July to September 2003
%; seasonally adjusted

Item	Ex-ports	Im-ports
Total	– 1.9	+ 4.5
Selected country/group of countries		
Euro-area countries	+ 2.4	+ 3.0
Other EU countries	+ 0.7	+ 0.8
United States	– 3.5	– 7.4
Japan	+ 0.5	+ 4.2
China	– 10.7	+ 14.3
Central and east European countries in transition	– 7.4	+ 9.0
OPEC countries	– 13.2	+ 15.6
Emerging markets in South-East Asia	– 2.2	+ 12.2
Categories of goods		
Selected main categories		
Intermediate goods	– 3.6	+ 4.7
Capital goods	+ 0.7	+ 5.1
Consumer goods	– 3.4	+ 4.1
Energy sources	.	+ 6.6
Selected categories		
Chemicals	– 5.0	+ 5.9
Machinery	– 4.1	+ 3.4
Motor vehicles and motor vehicle parts	+ 4.4	+ 1.4
Information technology	– 0.3	+ 10.3

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the competitive disadvantages in terms of price were partially offset by the favourable economic developments in these countries. Furthermore, a decline in prices (in euro) of exports to non-euro-area countries indicates that, in the period under review, German exporters attempted to counter the exchange-rate movements with price reductions. However, this probably had a negative affect on their profit margins.

The decline in exports mainly affected the consumer and intermediate goods sectors (-3½% in both cases). On an average of October and November fewer chemical engineering goods and metal products were exported than in the third quarter. By contrast, capital goods exports were slightly up on the level in the preceding quarter. Exports of motor vehicle equipment increased in particular. In contrast to the general trend, exports in this sector were 4½% above their level in the third quarter. The introduction of new models by German manufacturers in the autumn may have had an impact in this respect.

Imports of goods

In contrast to exports, seasonally adjusted German imports of goods in the fourth quarter were 4% up on the third quarter of 2003. As imports of goods had previously declined even more than would have been consistent with the slight fall in domestic demand, this development was probably mainly due to changes in timing, which were reflected in corresponding stock movements, and to increased imports of intermediate goods in connection with the substantial rise in industrial production. The growth in imports was particularly noticeable in the case of deliveries from China (14½%), which now accounts for approximately 5% of German imports. However, considerably more goods were also imported from the South-East Asian emerging markets (+12%) and the central and east European transition countries (+9%) than in the reference period. Some of these countries gained competitive advantages over German suppliers as a result of the appreciation of the euro. By contrast, there was a more moderate increase in imports from the other euro-area countries (+3%). Imports from the United States, at 7½% in nominal terms, declined sharply although the month-to-month fluctuations – presumably also exchange-rate-related – are rather substantial.

A breakdown by sector shows that all the major economic sectors participated in the rise in imports. However, the increase in the information and communications technology sector was particularly sharp (+10½%). This coincides with recent observations that the highest growth rate recorded on the global PC market over the past three years was in the fourth quarter of 2003. Imports of capital goods also increased at an above-average rate (+5%); however, there was also a demand for foreign consumer and intermediate goods.

Current account

After adjustment for seasonal variations, the slight decline in exports of goods and the sharp rise in imports in the fourth quarter of 2003 resulted in a decline of €6½ billion to €32 billion in Germany's trade surplus. At the same time, the deficit in invisible current account transactions with non-residents from October to December was smaller than in the preceding three-month period. For example, the deficit on Germany's services account was somewhat smaller than in the previous quarter, as were the net current transfers to non-residents. With regard to cross-border factor income, the direction of the (net) flows of payments was reversed. In the final quarter of 2003 there were net receipts of €½ billion. As a result, in the fourth quarter of 2003 the German current account ran a seasonally adjusted surplus of €15½ billion, compared with one of approximately €19½ billion in the previous quarter.

Financial transactions

Trends in financial transactions

The driving forces behind the upswing in the world economy, which had continued to gain strength up to the end of 2003 and increas-

Major items of the balance of payments

€ billion

Item	2002 Q4	2003 Q3	2003 Q4
I Current account			
1 Foreign trade [1]			
Exports (fob)	168.6	165.6	171.2
Imports (cif)	136.4	126.7	139.6
Balance	+ 32.2	+ 38.9	+ 31.6
2 Services (balance)	– 5.5	– 12.6	– 4.8
3 Factor income (balance)	+ 4.3	– 3.8	+ 2.1
4 Current transfers (balance)	– 7.4	– 8.2	– 6.9
Balance on current account [2]	+ 21.6	+ 12.9	+ 19.6
Memo item Balances, seasonally adjusted			
1 Foreign trade	+ 32.5	+ 38.6	+ 32.1
2 Services	– 9.0	– 8.9	– 8.1
3 Factor income	+ 2.1	– 1.4	+ 0.4
4 Current transfers	– 7.2	– 7.7	– 6.7
Current account [2]	+ 16.5	+ 19.3	+ 15.4
II Balance of capital transfers [3]	– 0.4	+ 0.2	+ 0.1
III Balance of financial account [4]	– 47.2	– 2.4	– 24.5
IV Change in the foreign reserves at transaction values (increase: –) [5]	+ 0.9	– 0.8	+ 1.2
V Balance of unclassifiable transactions	+ 25.0	– 10.0	+ 3.5

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 54. — **5** Excluding allocation of SDRs and changes due to value adjustments.

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Financial transactions

€ billion, net capital exports: –

Item	2002 Q4	2003 Q3	2003 Q4
1 Direct investment	– 0.6	+ 1.4	– 15.3
German investment abroad	– 6.3	– 5.0	– 1.6
Foreign investment in Germany	+ 5.7	+ 6.3	– 13.7
2 Portfolio investment	– 12.3	– 9.7	+ 19.6
German investment abroad	– 9.4	– 5.5	– 15.6
Shares	– 5.4	– 0.7	– 5.8
Investment fund certificates	+ 0.6	– 0.2	– 0.6
Bonds and notes	– 7.2	– 1.2	– 6.9
Money market paper	+ 2.6	– 3.4	– 2.3
Foreign investment in Germany	– 2.9	– 4.2	+ 35.2
Shares	+ 2.5	+ 3.4	+ 21.3
Investment fund certificates	– 1.3	– 0.8	+ 0.2
Bonds and notes	– 0.6	+ 5.3	+ 13.4
Money market paper	– 3.6	– 12.0	+ 0.3
3 Financial derivatives 1	+ 0.3	+ 0.3	– 0.3
4 Credit transactions	– 34.3	+ 6.2	– 27.8
Credit institutions	– 49.8	+ 20.0	– 30.2
Long-term	– 6.3	– 15.6	+ 1.1
Short-term	– 43.6	+ 35.6	– 31.4
Enterprises and individuals	+ 15.7	– 0.7	+ 11.1
Long-term	+ 1.1	+ 0.4	– 1.2
Short-term	+ 14.6	– 1.1	+ 12.3
General government	– 0.4	+ 2.1	– 0.4
Long-term	– 0.1	+ 0.1	+ 1.3
Short-term	– 0.2	+ 2.0	– 1.7
Bundesbank	+ 0.2	– 15.2	– 8.2
5 Other investment	– 0.3	– 0.6	– 0.7
6 Balance of all statistically recorded capital flows	– 47.2	– 2.4	– 24.5
Memo item Change in the foreign reserves at transaction values (increase: –) 2	+ 0.9	– 0.8	+ 1.2

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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ingly affected the euro area, had a considerable impact on the international financial markets. Stock prices continued to rise up to the end of the year whereas the prices of longer-term bonds declined overall. At the same time, there was a further upward surge in the euro, a development which was fed by concerns about global balance of payment disequilibria. It was against this backdrop that in the period under review both the euro area, in general, and Germany, in particular, became more attractive locations for portfolio investments and consequently – according to the figures available to date – drew in significant amounts of money from abroad.

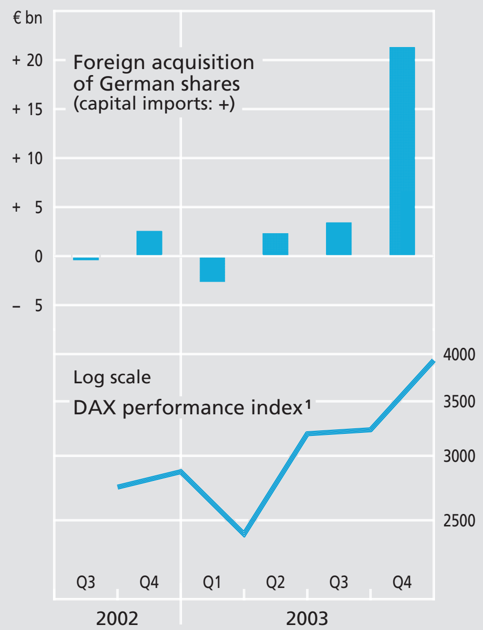
Portfolio investment

Thus in the final quarter of 2003, portfolio investments on the German market raised €19½ billion net, which, compared with the net capital exports in the preceding quarter (€9½ billion), constituted a considerable turnaround in the direction of the international movement of capital. Greater new investment on the German securities markets was particularly evident in the case of foreign investors. Whereas in the preceding quarter, in a market that was generally marked by fairly substantial risks, non-resident investors had sold German securities (€4 billion), in the period from October to December they purchased German securities for €35 billion. There was particularly strong demand for shares issued by German enterprises. Non-residents acquired such shares to the value of €21½ billion after purchasing only €3 billion worth of this kind of paper earlier in 2003. This development was no doubt due, in part, to the general decline in uncertainty – measured in terms of the implicit volatility of the

Foreign investment in German securities

DAX – and to the renewed improvement in sentiment that emerged on the German stock exchanges at the end of the third quarter – based on favourable profit forecasts for German companies. This sentiment persisted until the end of the year and resulted in a rise of almost 22% in share prices, which was substantial by international standards.[1] However, there was also a strong demand among foreign investors for German bonds and notes in the final quarter of 2003. They almost tripled their net acquisitions here (€13½ billion compared with €5½ billion in the previous quarter). Once again there was strong demand for bank debt securities in particular (€12½ billion compared with €15 billion). The spread of these securities over public bonds fell by a further two basis points in the period under review – in line with the trend over the past few months. Whereas money market paper had been particularly popular with global investors at the beginning of the year, in the period from October to December foreign investors purchased just under €½ billion worth of it – a further sign of declining uncertainty on the market.

Equity market in Germany



1 End-of-quarter data; end-1987 = 1000; Source: Deutsche Börse AG.

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German investment in foreign securities

For the same reasons, German financial market players were also somewhat less restrained and again invested fairly large sums in foreign securities. In the quarter under review, they purchased €15½ billion worth of foreign paper, compared with €5½ billion in the preceding quarter. As in the previous three months, they demonstrated a slight preference for fixed-rate debt securities issued by non-resident borrowers (€7 billion compared with just under €1 billion) over dividend-bearing paper issued by foreign public limited companies (€6 billion compared with just over €½ billion). Regional figures, where available, show that despite the weak US dollar, German investors acquired a considerable net amount of stocks and bonds from the United States in the period under review. Apparently the prospect of robust US economic growth in 2004 weighed more strongly with German investors than concern about a further depreciation of the dollar. As in the past, however, euro-denominated bonds from other euro-area countries made up a large share of the investment volume in bonds and notes. By contrast, German savers paid less attention to foreign money market

1 In the same period (from the end of September to the end of December) other major financial centres recorded much slower index growth, ranging from 4½% (Nikkei) to approximately 13% (the US Dow Jones index and the Dow Jones EuroStoxx index).

paper (€2½ billion) and investment fund certificates (€½ billion) when making portfolio decisions.

Credit transactions of non-banks

In the period under review, capital imports also predominated in the area of non-securitised credit transactions of non-banks with non-residents (€10½ billion net) whereas in the preceding quarter inflows and outflows of capital had been roughly in balance. As is usual at the end of the year, enterprises and individuals, in particular, repatriated a considerable amount of funds which they had held in bank accounts abroad, one of the reasons being to reduce the number of outstanding loans in their closing balances (window dressing). By contrast, general government cross-border credit transactions were almost in balance in the last quarter of 2003 (outflow of €½ billion).

Direct investment

However, in the case of direct investment, where the reaction to cyclical factors or events on the financial markets is generally not as rapid as it is in portfolio investment, outflows of capital predominated at €15½ billion in the period under review while in the two preceding quarters of 2003 there had been net capital imports (totalling €25 billion).

Foreign direct investment in Germany

The main reason for this development was the change in the investment and borrowing behaviour of foreign enterprises. Although they expanded their participating interests in Germany by €9½ billion between October and December, at the same time foreign affiliates domiciled in Germany made considerable repayments on longer-term loans, which they had previously taken out with their non-resident parent or affiliated companies. Thus, overall, the value of foreign direct investment in Germany declined by €13½ billion, having previously risen steadily throughout the earlier part of the year. Firms in the United States, as well as Belgium and Luxembourg (the favoured locations for holding companies), were the main ones to receive extensive repayments on loans from their German branches. In the three-month period under review, German investors, unlike foreign proprietors, once again kept a somewhat tighter hold on their subsidiaries and branches domiciled abroad. Altogether they transferred €1½ billion of funds to them (compared with €5 billion between July and September). This time the favoured destinations of German enterprises were partner countries outside the European Union.

German direct investment abroad

Credit transactions of the banking system

The external assets of the German banking system increased by €38½ billion, partly as a reflection of the large net inflows arising from the securities transactions and credit transactions of the non-banks. German credit institutions generally tended to reduce their unsecuritised liabilities vis-à-vis their foreign partners while the growth in the Bundesbank's assets primarily resulted from the large-value payment system TARGET (€8 billion).

Bundesbank foreign reserves

The foreign reserves of the Bundesbank, which are shown separately from cross-border credit transactions in the balance of payments, declined by €1 billion at transaction values between the end of September and the end of the year. Thus the annualised stock of foreign reserve assets declined by

€½ billion owing to transaction-related disposals. However, the considerable valuation changes had a much stronger impact on the Bundesbank's balance sheet and the slight holding gains in the case of gold were unable to offset the sharp losses in the currency position as a result of the weak US dollar. At the end of 2003 Germany's foreign reserves amounted to the equivalent of €76½ billion compared with €81 billion at the end of September 2003 and just over €85 billion at the beginning of last year.