Foreign trade and payments

Foreign trade and current account

External environment

The external environment in the second quarter of 2004 was marked by the strong expansion of world trade. The USA and Asia once again provided particularly dynamic impulses for foreign trade but the economic recovery in European countries also made further progress. The German economy contributed to the brisk demand on foreign markets to a notable extent and, in doing so, again demonstrated its international competitiveness. In this way, orders received from abroad grew by 4% in seasonally adjusted terms in the second quarter of the year compared with the first and industry's continuing favourable assessment of export expectations suggests that this development has also continued in the summer months.

Exports of goods

Exports again showed particularly buoyant growth in the second quarter of 2004. German exports increased in value and in seasonally adjusted terms by 4% compared with the first quarter. This means that they were in line with the very good result of the previous three-month period (+4.5%). The increase in exports was not much smaller in real terms either, ie after deducting the simultaneous rise in export prices (+½% in seasonally adjusted terms).

Breakdown of exports

According to the statistical information so far available on the regional structure of foreign trade in the second quarter (up to and including May), the marked growth in the German economy's export business was spread broadly across the various countries and groups of countries. Only in foreign trade with Japan and Russia was there a decline in exports on an average of April and May. Owing to the comparatively small volume of German exports to these countries, coincidences may also have played a part, with the result that no significant conclusions should be drawn from them.

Germany's export business with China remained very favourable. The highest growth during the period under review was achieved here with an increase in turnover of 14½%. The growing importance of this market for the German economy is also becoming clear in that its share of total German exports has now risen to 3½% compared with approximately 2% in 2002. Yet the increase in exports to other centres of growth was also disproportionately sharp. This is true of exports to the USA, for example, which went up by 10% in the spring months. There was also a marked increase in trade with the developing and OPEC countries during the period under review. In all, German exports to non-euro-area countries rose on an average of April and May by 6½% compared with the first quarter. The appreciation of the euro in the last two years, which may also be interpreted as a correction of the previous weakness of the euro, does not therefore seem to have decisively affected the German economy's export business. By contrast, at 4½%, the increase in exports to the euro-area countries during the period under review was not quite so dynamic. Owing to their important role in terms of total German exports, these exports have also significantly influenced the overall result.

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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The rise in exports to EU countries that are not part of the euro area was somewhat sharper (+5%). German export turnover thus increased by 6% in the United Kingdom, Sweden and Denmark altogether. By con-

Trend in foreign trade by region and by category of goods

Average of April and May 2004 compared with the average of January to March 2004
%; seasonally adjusted

Item	Exports	Imports
Total	+ 5.7	+ 3.4
Selected country/group of countries		
Euro-area countries	+ 4.5	+ 0.0
Other EU countries	+ 4.8	+ 0.3
United States	+ 9.9	+ 23.0
Japan	– 10.7	+ 5.1
China	+ 14.4	+ 19.2
Russia	– 1.2	+ 16.2
OPEC countries	+ 6.7	– 20.5
Developing countries excluding OPEC	+ 6.2	+ 9.8
Categories of goods		
Selected main categories		
Intermediate goods	+ 3.5	+ 1.4
Capital goods	+ 5.3	+ 8.1
Consumer goods	+ 3.3	+ 2.4
Energy sources	.	– 1.7
Selected categories		
Chemicals	+ 2.7	– 0.7
Machinery	+ 5.5	– 0.2
Motor vehicles and motor vehicle parts	+ 7.5	+ 5.7
Information technology	+ 0.0	+ 10.1
Metals and metal products	+ 5.3	+ 1.4

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trast, exports to the ten new member states[1], which have a market share of 8½%, went up by only 3%. While large increases in exports to Poland (+11½%) and the Czech Republic (+7½%) were achieved, a decline in turnover was recorded in exports to Hungary (-3½%), for example.

Almost all industries were able to benefit from the considerable increase in exports, in particular, the manufacturers of capital goods (+5½%), which traditionally account for a large share of German exports (around 45%). Accordingly, foreign demand for machinery and metal products has continued to increase noticeably following the steep rise in the last quarter. In addition, exports of motor vehicles, which amount to almost one fifth of German exports, recovered. The motor industry's export turnover rose considerably compared with the previous quarter (+7½%), making up for the considerable decline (-4%) during the winter months. By contrast, there was a below-average increase in exports of German intermediate and consumer goods (+3½% in each case).

Imports of goods

German imports increased in value and in seasonally adjusted terms by 2½% in the second quarter compared with the first. However, this was largely a result of price developments. The rise in (seasonally adjusted) prices of imported goods amounted to 1½% compared with the previous quarter, with the result that the increase in real imports of goods was correspondingly smaller. This price rise was mainly caused by the higher raw material and energy prices. Not least in view of the considerable increase in import prices for energy sources (+11½% on an average of April and May), the correspondent nominal imports dropped by 1½%. This was likewise visible in the noticeable decline in imports from the OPEC countries. In contrast to the two previous quarters, imports of intermediate goods did not increase very sharply either (+1½%). On the other hand, imports of capital goods rose particularly steeply (+8%). That could suggest a certain revival of domestic investment demand; in view of the international division of production processes, however, this should also be seen in connection with the large number of exports, in par-

1 The recording of trade with the ten new member states that joined the EU on 1 May 2004 has been moved from extra to intra trade statistics. By doing so, the foreign trade data may initially be subject to greater uncertainty. Trade with the ten new accesssion countries has already been included in EU trade since the beginning of the year.

ticular, of machinery. Domestic demand for imports of communication and information technology goods was also very buoyant (+10%). By contrast, imports of consumer goods went up only moderately (+2½%).

The rise in demand for imports focused on suppliers outside the euro area. The import value from the other euro-area countries remained unchanged, however. In real terms, there was even a minor fall in imports from the euro area owing to the slight rise in the prices of imported goods. In terms of value, German demand for products from the United Kingdom, Sweden and Denmark also declined (–½% overall). By contrast, imports from the new EU member states, which now make up 11% of all German imports, increased slightly over the period under review (+1%). Meanwhile, imports from the USA (+23%) and South-East Asia (+16%) rose particularly sharply. This can presumably be viewed in connection with the high demand for imports of information and communication technology products in Germany. There was also a steep increase in imports from Russia (+16%).

Current account

The strong demand for imports in some sectors has not achieved the same high level of growth as for exports, however, with the result that, at €43½ billion in the second quarter of 2004, net exports were €4½ billion up on the first quarter of the year in seasonally adjusted terms. In addition to the increased trade surplus, the invisible current transactions balance also improved, particularly owing to a somewhat lower deficit on services. Furthermore, this mirrors the slightly

Major items of the balance of payments

€ billion

Item	2003 Q2	2004 Q1	2004 Q2
I Current account			
1 Foreign trade [1]			
Exports (fob)	162.6	177.2	185.4
Imports (cif)	132.1	136.0	142.4
Balance	+ 30.4	+ 41.1	+ 43.0
2 Services (balance)	– 8.3	– 8.9	– 8.1
3 Factor income (balance)	– 3.6	– 3.9	+ 1.0
4 Current transfers (balance)	– 7.9	– 5.6	– 7.1
Balance on current account [2]	+ 8.7	+ 21.3	+ 26.7
Memo item Balances, seasonally adjusted			
1 Foreign trade	+ 31.2	+ 39.2	+ 43.5
2 Services	– 8.7	– 9.0	– 8.3
3 Factor income	– 5.7	– 1.1	– 1.0
4 Current transfers	– 7.6	– 7.1	– 6.7
Current account [2]	+ 7.6	+ 20.4	+ 25.5
II Balance of capital transfers [3]	+ 0.1	+ 0.4	+ 0.2
III Balance of financial account [4]	– 25.4	– 14.4	– 71.3
IV Change in the foreign reserves at transaction values (increase: –) [5]	+ 1.5	+ 0.2	– 0.3
V Balance of unclassifiable transactions	+ 15.0	– 7.5	+ 44.8

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 50. — 5 Excluding allocation of SDRs and changes due to value adjustments.

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Financial transactions

€ billion, net capital exports: –

Item	2003 Q2	2004 Q1	2004 Q2
1 Direct investment	+ 19.2	– 21.9	– 9.0
German investment abroad	+ 15.3	+ 10.2	– 3.3
Foreign investment in Germany	+ 3.9	– 32.1	– 5.7
2 Portfolio investment	+ 10.2	+ 8.1	– 32.2
German investment abroad	– 25.8	– 26.0	– 31.8
Shares	– 1.3	+ 1.2	+ 1.0
Investment fund certificates	– 0.3	– 7.1	– 2.6
Bonds and notes	– 20.5	– 26.1	– 25.8
Money market paper	– 3.8	+ 6.0	– 4.3
Foreign investment in Germany	+ 36.0	+ 34.1	– 0.4
Shares	+ 4.3	+ 2.8	– 12.0
Investment fund certificates	– 0.1	+ 0.8	– 1.0
Bonds and notes	+ 30.8	+ 42.9	+ 15.1
Money market paper	+ 1.1	– 12.5	– 2.5
3 Financial derivatives 1	– 2.5	– 1.3	+ 2.3
4 Credit transactions	– 51.6	+ 1.6	– 31.6
Monetary financial institutions 2	– 67.0	+ 21.3	– 67.2
Long-term	– 8.1	– 5.3	+ 4.1
Short-term	– 58.9	+ 26.6	– 71.3
Enterprises and individuals	– 6.4	– 9.6	+ 1.7
Long-term	+ 0.6	+ 2.4	– 0.1
Short-term	– 7.1	– 12.0	+ 1.9
General government	+ 1.2	– 3.0	+ 2.6
Long-term	– 0.1	– 1.9	+ 1.4
Short-term	+ 1.3	– 1.1	+ 1.2
Bundesbank	+ 20.6	– 7.0	+ 31.3
5 Other investment	– 0.6	– 1.0	– 0.7
6 Balance of all statistically recorded capital flows	– 25.4	– 14.4	– 71.3
Memo item Change in the foreign reserves at transaction values (increase: –) 3	+ 1.5	+ 0.2	– 0.3

1 Securitised and non-securitised options and financial futures contracts. — **2** Excluding the Bundesbank. — **3** Excluding allocation of SDRs and changes due to value adjustments.

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declining deficit on current transfers. There was little change in net expenditure on cross-border factor income compared with the previous quarter. Altogether, this resulted in a seasonally adjusted current account surplus of €25½ billion, which was €5 billion up on the previous quarter.

Financial transactions

Trends in financial transactions

The continuing strong growth in the world economy, which was partly accompanied by incipient inflation concerns in the USA, was also reflected in the international financial markets. Thus, yields of longer-term paper increased globally at the beginning of the second quarter whereby the interest rate rise in the USA, whose economy continues to expand more quickly than that of the euro area and Germany, was considerably sharper than in Germany. In addition, the US central bank raised its key interest rates for the first time in over four years against the background of strong economic development and rising prices. At the same time as the interest rate differential between European and US long-term bonds and notes grew, the euro exchange rate initially went down. However, with the announcement of continuing high US trade deficits and the prevailing assessment that the US central bank is likely to raise interest rates only gradually, the euro again made up some ground on the dollar. In this area of conflict between good economic data on the one hand, and rising interest rates on the other, share indices in the major financial centres closed almost unchanged in the second quarter after marked fluctuations. To some extent, the above-mentioned developments are also evident from German financial transactions with non-residents. All in all, there were outflows of funds from Germany through direct and portfolio investment between April and June. According to current statistics for the euro area, this has also been the case for the euro area as a whole.

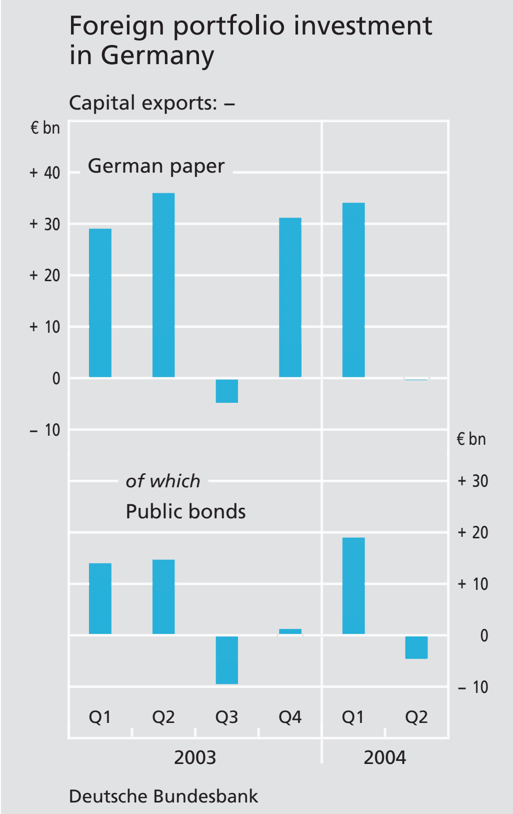
Portfolio investment

In German portfolio transactions with non-residents, in which new underlying economic conditions are generally reflected very quickly, there were substantial net outflows of capital amounting to €32 billion in the second quarter of 2004 compared with net inflows of funds during the previous three-month period (€8 billion).

Foreign investment in German securities

The main reason for this turnaround in portfolio investment was the reorientation of foreign investors, who sold a total of €½ billion of German securities. In the first three months of 2004, they had increased their portfolios of German investment by €34 billion. In particular, there was less demand for bonds and notes, which non-residents acquired for just €15 billion, after having invested €43 billion in such paper in the previous quarter.

It is possible that the change in the international security situation contributed towards this development. Whereas concerns over international terrorism persuaded foreign investors to park larger sums in the "safe haven" of German government debt in the first three months of 2004, the fact that the assessment of geopolitical risks is now somewhat calmer overall led to a counter-



movement in investor behaviour to a certain extent. In any case, only public bonds, which are particularly in demand at uncertain times, were affected by the foreigners' withdrawal (€-4½ billion compared with €+19 billion). At the same time, private bonds continued to arouse interest, although the amount of new investment recorded in this respect was somewhat lower (€19½ billion compared with €24 billion).

Another argument in favour of the view that precautionary considerations played a less prominent role during the period under review is the fact that the interest rate advantage of Bunds compared with paper from other euro-area countries, which had increased significantly following the terrorist attacks in Madrid, has recently been eroded –

and this despite rising yields overall. However, non-resident investors also moved from buying to selling shares of German firms (€12 billion compared with purchases of €3 billion in the previous quarter). It is possible that these sales are linked to the shifts in institutional investors' specimen portfolios, some of whom restructured their positions into German paper. However, the restructuring does not seem to have exerted any particular influence on the DAX's price movements as the share indices of important markets moved largely in the same direction in the period under review. At the end of June 2004, they were close to the level at which they began the quarter. Furthermore, non-resident investors sold part of their holdings of German money market paper, as in the two previous three-month periods.

German investment in foreign securities

German investors continued to show keen interest in foreign investment opportunities (€32 billion net compared with €26billion). Despite prices falling overall, foreign bonds and notes once again appealed to them (€26 billion), mostly euro-denominated sovereign debt from other euro-area countries (€24 billion). This means that, all in all, €45½ billion has already flowed into these instruments in the first half of 2004. This is more than in the whole of 2003 (€31½ billion) and only slightly less than in 2002 (€48 billion). The underlying sentiment regarding foreign equities, which has been decidedly cautious for some time, may also play a role in addition to the somewhat higher return compared to Federal government benchmark bonds and, as mentioned above, the repatriation of "safe haven" investments they had previously set up. In any case, German financial market players also withdrew from the global stock markets to a certain extent in the second quarter (€1 billion) after having already sold a small proportion of their foreign holdings of participatory securities in the previous quarter. New German investment in foreign investment certificates also declined (€2½ billion compared with €7 billion in the previous quarter). German investors added money market paper, ie debt securities with a residual maturity of up to one year, to their portfolios for €4½ billion after having withdrawn €6 billion from this instrument in the previous quarter.

Direct investment

As in the case of portfolio investment, there were also net capital outflows through direct investment from April to June, which, at €9 billion, were considerably lower than in the previous quarter (€22 billion). Both the activities of foreigners in Germany and investment by Germans abroad contributed towards these net capital exports. Weak direct investment in both directions of financial flows stood in contrast to the relatively strong global economy to a certain extent during the period under review. However, a completely normal delayed reaction of direct investment to the changed economic environment can possibly be expected.

Foreign direct investment in Germany

Foreign investors continued to withdraw net capital from April to June of this year following the two preceding three-month periods having been characterised by net capital exports by foreign investors in Germany. However, at €5½ billion, the extent of this was much lower than previously. Compared to this, net holdings of direct investment funds in the euro area as a whole hardly changed, according to the statistical data currently available. Just over half of the outflows of funds from Germany can be traced back to foreigners repatriating their investment capital by €3 billion after having added to it in the previous quarter (€5 billion). Outflows of funds totalling €1½ billion were also recorded in the granting of shareholder loans from foreign enterprises to their German subsidiaries. However, these were noticeably lower than the previous quarter's capital exports of €30 billion. One single transaction within the telecommunications sector shaped development in equity capital in June.

German foreign direct investment

German firms slightly extended their investment abroad from April to June (€3½ billion) after having withdrawn funds from abroad in the final quarter of 2003 and the first quarter of 2004 (€11½ billion). The main reason for this was that they added €2½ billion to their equity capital abroad. There was a minor inflow of capital in the case of loans within affiliated enterprises (€1 billion). It appears that holding companies in the Netherlands were involved in these transactions to a major extent.

Credit transactions of non-banks

Whereas net capital exports were recorded in portfolio investment and direct investment, net inflows of funds amounting to €4½ billion resulted from the non-banks' non-securitised credit transactions. Transactions made by German enterprises and individuals, which amounted to €1½ billion net, accounted for the smaller part of this figure. They mostly reduced their deposits with foreign banks. The financial operations of public authorities likewise resulted in inflows of funds amounting to €2½ billion.

Credit transactions of the banking system

In addition to the capital flows arising through portfolio investment and direct investment, net outflows of funds totalling €36 billion also resulted from the activities of the monetary financial institutions (including the Bundesbank). It was exclusively the operations of the monetary financial institutions (excluding the Bundesbank) which led to capital exports through short-term credit transactions. By contrast, overall, funds accrued to the banking system through long-term transactions and those made by the Bundesbank that are classified as credit transactions (€4 billion and €31½ billion respectively). The latter can primarily be traced back to a reduction in the claims on partner central banks within the Eurosystem previously accrued as part of the large-value 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, remained almost unchanged at transaction values. Valued at market prices at the end of the quarter under review, however, the foreign reserves fell by €3 billion to €77 billion. The main reason for this was the decline in the market value of gold whereas the slight depreciation of the US dollar against the euro had only minor effects.