Foreign trade and payments

Foreign trade and current account

External environment

In the third quarter of 2004 world economic growth lost momentum as a result of the sharp rise in oil prices. Under these circumstances German exporters benefited mainly from demand from euro-area partner countries. They were assisted in this by price and cost movements which were more favourable in Germany than in the rest of the euro area. Primarily as a result of the higher foreign demand for intermediate and capital goods, orders received from abroad in the third quarter grew by a seasonally adjusted 1% over those of the second quarter. Furthermore, industry's export expectations as recorded by the Ifo Institute continue to be decidedly positive. Consequently, somewhat more buoyant export sales are again emerging for German enterprises during the rest of 2004 even if growth rates remain below the record figures reached in the first half of the year. How German foreign trade subsequently develops will greatly depend on how the world economy copes with the "oil price shock" and whether the recent re-emergence of exchange rate uncertainties will result in a substantial downturn in German exporters' price competitiveness.

Exports of goods

Following the dynamic export activity in the first half of 2004, the seasonally adjusted value of exports of goods in the third quarter grew by no more than about ½% compared with the second quarter. In real terms, ie after taking account of the simultaneous increase in export prices (+½% seasonally adjusted), export sales just managed to reach the level attained in the previous quarter.

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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Breakdown of exports

According to the statistics on the regional breakdown of foreign trade, which extend only up to the end of August so far, the robust growth in German exports was due solely to the increased demand from the euro area. These statistics show that German exports to other euro-area countries, which – with a current 44% share of Germany's total export turnover – play a major role in German foreign trade, increased by a seasonally adjusted 2½% on an average of July and August compared with the second quarter. By contrast, exports to non-euro-area countries did not repeat the strong performance of the previous quarter but, instead, fell by 2½%.

The expansion in exports to other parts of the euro area was due mainly to the rise in the sales of German goods to Austria (+5½%) and to the Benelux countries (+4%). The heaviest demand from countries outside the euro area came from Denmark (+8½%) and Japan (+10½%). However, these countries were unable to offset the decline in total exports to non-euro-area countries, the main reason for the decline being the downturn in goods exported to countries outside the EU. Even so, as exports of German products to most non-euro-area countries on an average of July and August were only slightly below the generally very high level of the previous quarter, substantial losses were recorded in only a few countries. One such country was China, where the rapid growth in the sales of German products during the previous two quarters was not repeated. Instead, there was a decline of 17½% in July-August. However, trade with China had always been subject to fairly sharp fluctuations, partly as a result of large orders. Exports to the United States (-3%) and the emerging markets of South-East Asia (-4%) continued to show a certain weakness. This did not fail to have an effect on the export sales of the German motor industry, which did not quite regain the high level of the previous quarter.

While the exports of capital goods and, more especially, consumer goods declined on an average of July and August, the exports of German enterprises were boosted by the continuing increase in demand for German intermediate goods. Among the sources of support for the upturn in sales in July and August was the growth in exports enjoyed by the metal industry (+2%) and the chemical industry (+1½%). In addition, there was a sharp expansion in the exports of information and communication technology products (+3%). In contrast to the motor industry, however, the manufacturers of mechanical engineering products continued to increase their export sales (+1%).

Imports of goods

The seasonally adjusted value of German imports again rose significantly in the third quarter (+4½%). According to the data for July and August, which are already available, the increase in the imports of goods from other euro-area countries (+5%) was somewhat faster than from non-euro-area countries (+3½%). However, part of the increase in the value of imports was due to the increased price of imported goods (+1% in seasonally adjusted terms in the third quarter). The higher import prices can be attributed almost solely to the rise in energy prices and commodity prices. For example, the seasonally adjusted value of Germany's total energy imports again rose somewhat more sharply in July-August (+9½%) than in the previous quarter. In view of the 9% rise in the import prices of energy products in July and August compared with the previous quarter, however, the change in terms of volume was slight.

Trend in foreign trade by region and by category of goods

Average of July and August 2004 compared with the average of April to June 2004
%; seasonally adjusted

Item	Exports	Imports
Total	+ 0.4	+ 4.2
Selected country/group of countries		
Euro-area countries	+ 2.5	+ 5.2
Other EU countries	+ 0.2	+ 1.6
United States	– 3.0	– 7.2
Japan	+ 10.4	+ 3.0
China	– 17.7	+ 7.1
Russia	+ 1.6	– 6.7
OPEC countries	+ 0.0	+ 23.7
Emerging markets in South-East Asia	– 4.0	+ 3.0
Categories of goods		
Selected main categories		
Intermediate goods	+ 1.2	+ 6.7
Capital goods	– 1.8	+ 1.4
Consumer goods	– 3.3	– 1.1
Energy sources	.	+ 9.5
Selected categories		
Chemicals	+ 1.4	+ 0.4
Machinery	+ 0.9	+ 5.9
Motor vehicles and motor vehicle parts	– 0.6	+ 6.5
Information technology	+ 2.8	+ 2.1
Metals and metal products	+ 1.9	+ 9.7

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The increase in Germany's energy imports that were primarily due to price changes is reflected in a substantial rise in the nominal imports from the OPEC countries. Following the sharp downturn in the second quarter, these imports, which are almost entirely in the form of energy products, grew by nearly one-quarter on average in July and August compared with the previous few months. Imports from the United Kingdom also expanded strongly (+13½%) in the third quarter, not least as a result of the higher demand for British chemical products and even more so for energy sources. Although nominal imports from Russia declined during the period under review, they, too, were significantly greater in July and August than at the end of 2003 given the 18½% growth rate in the second quarter. The main reason for the fact

Major items of the balance of payments

€ billion

Item	2003 Q3	2004 Q2	2004 Q3
I Current account			
1 Foreign trade [1]			
Exports (fob)	166.3	185.3	180.5
Imports (cif)	127.9	142.3	143.9
Balance	+ 38.4	+ 43.0	+ 36.6
2 Services (balance)	– 13.3	– 7.6	– 13.3
3 Factor income (balance)	– 4.5	+ 0.0	– 4.1
4 Current transfers (balance)	– 8.8	– 7.1	– 8.0
Balance on current account [2]	+ 10.3	+ 26.2	+ 8.0
Memo item Balances, seasonally adjusted			
1 Foreign trade	+ 38.5	+ 41.9	+ 36.7
2 Services	– 9.2	– 7.8	– 9.3
3 Factor income	– 3.6	– 2.3	– 3.6
4 Current transfers	– 8.0	– 6.8	– 7.2
Current account [2]	+ 16.5	+ 23.1	+ 13.8
II Balance of capital transfers [3]	+ 0.2	+ 0.2	+ 0.2
III Balance of financial account [4]	– 5.2	– 67.9	– 31.2
IV Change in the foreign reserves at transaction values (increase: –) [5]	– 0.8	– 0.3	+ 1.6
V Balance of unclassifiable transactions	– 4.5	+ 41.8	+ 21.5

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 52. — 5 Excluding allocation of SDRs and changes due to value adjustments.

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that the value of imports from Russia has been tending to rise is probably also attributable here to the substantial increase in the prices of energy and commodity imports.

Generally speaking, another reason for the dynamic rise in imports was a certain need to catch up in view of the very careful stock management in the past and the sustained buoyancy of exports. Consequently, German imports of intermediate goods increased particularly strongly (+6½%) while there was also a sharp rise in capital goods (+1½%). There were pronounced increases in the case of imports of metals and metal products (+9½%), motor vehicles and motor vehicle parts (+6½%) and machinery (+6%). Presumably as a result of the large share of intermediate goods imports, domestic demand for products emanating from all parts of Asia grew disproportionately fast. By contrast, imports of goods from the United States and from the ten new EU member states were more sluggish than in the previous quarter.[1] In line with the low propensity to consume in Germany, domestic demand for foreign consumer goods also continued to be subdued (-1%).

Current account

At €36½ billion, the value of net exports in the third quarter of 2004 was €5 billion lower in seasonally adjusted terms than it had been in the second quarter as Germany's import bill grew much more strongly than its export proceeds. The deficit on current invisible

1 As in the second quarter the recording of trade with the ten member states which acceded to the European Union on 1 May 2004 continues to be fraught with considerable uncertainty. This is due to the change in the method of recording foreign trade on that date.

transactions with non-residents increased simultaneously with the declining trade surplus in the third quarter. Not only did cross-border net payments of factor income increase by €1½ billion; the deficit on services likewise increased discernibly during the period under review (+€1½ billion). Furthermore, the deficit on current transfers also showed a slight rise. In the third quarter, the German current account therefore closed with a seasonally adjusted surplus of €14 billion compared with one of €23 billion in the preceding three-month period.

Financial transactions

Trends in financial transactions

Owing to the increase in crude oil prices, the financial markets focused their attention more sharply on the associated growth risks, in particular, in the fourth quarter, with the result that yields on longer-term bonds and notes on both sides of the Atlantic declined in the third quarter. Initially, the downturn in yields was particularly pronounced in the United States, which is more dependent on oil imports than elsewhere and whose current account deficit reached a record high in the same period. The exchange rate pattern therefore shifted in favour of the euro – despite the interest rate increases by the Fed. The aforementioned influences can also be seen to some extent in the figures on German financial transactions with non-residents. If portfolio investment and direct investment are taken together, the outcome was an inflow of funds into Germany.

Portfolio investment

In the case of portfolio investment, in which a change in economic circumstances generally has a particularly rapid effect on investor behaviour, the influx of funds amounting to €19 billion net was a return to the hitherto three-year trend towards capital imports which had been interrupted in the previous quarter by unusually large net capital exports (€30 billion).

Foreign investment in ...

The shift was particularly marked in the case of non-residents' investment in Germany. Whereas in the previous quarter foreign investors had been rather cautious with respect to their portfolio investment in Germany (€1½ billion), they again stocked up their portfolios quite considerably with German paper between July and September (€39 billion). The bulk of the foreign funds flowing into Germany during the quarter under review was invested in domestic debt securities (€34 billion compared with €15½ billion in the previous three-month period), with the funds being almost equally divided between private and public bonds. The decision in favour of fixed-interest securities may have had something to do with expectations of a decline in capital market yields. This assumption is also supported by the fact that some of the funds used to acquire German bonds actually came from the proceeds accruing to foreign investors from the sales of German money market paper (€6 billion), ie debt securities whose upside price potential is very limited in times of falling interest rates owing to their short maturities of one year or less.

... German bonds and notes

... German shares

It was also of great importance for German portfolio investment that foreign investors on

Financial transactions

€ billion, net capital exports: –

Item	2003 Q3	2004 Q2	2004 Q3
1 Direct investment	+ 2.8	– 7.5	– 8.7
German investment abroad	– 3.0	– 2.5	– 8.1
Foreign investment in Germany	+ 5.8	– 5.0	– 0.6
2 Portfolio investment	– 6.4	– 30.0	+ 19.1
German investment abroad	– 1.6	– 31.6	– 19.9
Shares	– 0.7	+ 0.9	+ 6.1
Investment fund certificates	– 0.2	– 2.5	– 3.1
Bonds and notes	– 0.9	– 25.6	– 17.7
Money market paper	+ 0.3	– 4.3	– 5.1
Foreign investment in Germany	– 4.8	+ 1.5	+ 39.0
Shares	+ 3.0	– 11.7	+ 6.7
Investment fund certificates	– 0.8	– 1.0	+ 4.0
Bonds and notes	+ 6.3	+ 15.4	+ 34.2
Money market paper	– 13.3	– 1.2	– 6.0
3 Financial derivatives 1	– 0.4	+ 2.2	– 2.7
4 Credit transactions	– 0.6	– 31.8	– 38.3
Monetary financial institutions 2	+ 20.0	– 67.2	– 5.1
Long-term	– 15.6	+ 4.1	+ 4.5
Short-term	+ 35.6	– 71.3	– 9.6
Enterprises and individuals	– 7.6	+ 1.5	– 3.6
Long-term	+ 0.8	– 0.4	– 2.8
Short-term	– 8.4	+ 1.9	– 0.8
General government	+ 2.1	+ 2.6	+ 3.2
Long-term	+ 0.1	+ 1.4	+ 1.5
Short-term	+ 2.0	+ 1.2	+ 1.8
Bundesbank	– 15.2	+ 31.3	– 32.8
5 Other investment	– 0.7	– 0.7	– 0.6
6 Balance of all statistically recorded capital flows	– 5.2	– 67.9	– 31.2
Memo item Change in the foreign reserves at transaction values (increase: –) 3	– 0.8	– 0.3	+ 1.6

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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the German share market switched from selling to buying and acquired German equities worth €6½ billion. One possible factor contributing to the more buoyant demand was the internationally more favourable price-earnings ratio of German shares, which in the period under review stood at 12 and was therefore much more attractive than the corresponding ratios in the United States and Japan. Another factor encouraging investment in Germany, especially by non-euro-area residents, may have been the prospect of a rising euro exchange rate. After all, it was primarily investors from outside the euro area that were interested in dividend-bearing paper.

Foreign investment in ...

At the same time, investment by German residents on world markets declined during the quarter under review (€20 billion compared with €31½ billion in the previous quarter). Between July and September they purchased longer-dated bonds worth only €17½ billion compared with €25½ billion in the previous quarter. Once again it was the euro-denominated foreign government bonds which were most in demand (€16½ billion). As in the case of foreign investors, German residents may have chosen this form of investment partly because of the belief that the prices of bonds and notes still had a certain upside potential. This paper is also very popular because it usually offers a slightly higher yield than the benchmark Federal bond. When this report went to press, the spread between ten-year government bonds issued by other euro-area countries and comparable Federal paper was 11 basis points on average and therefore

... foreign bonds and notes

slightly below the "average spread" in the previous period (14 basis points).

...foreign shares

As in the first two quarters of the year, German investors sold foreign equities on balance (€6 billion compared with €1 billion in each of the previous two three-month periods). Evidently, they were responding to the price level of foreign shares, which is very much higher than that of German paper, and to the exchange rate risk to which they possibly saw themselves exposed when investing in cross-border shares. This was offset to a certain extent by the acquisition of mutual fund certificates of foreign funds (€3 billion), which traditionally invest part of their incoming capital in foreign shares. German investors also bought a net amount of money market paper issued by foreign borrowers and worth €5 billion.

German direct investment abroad

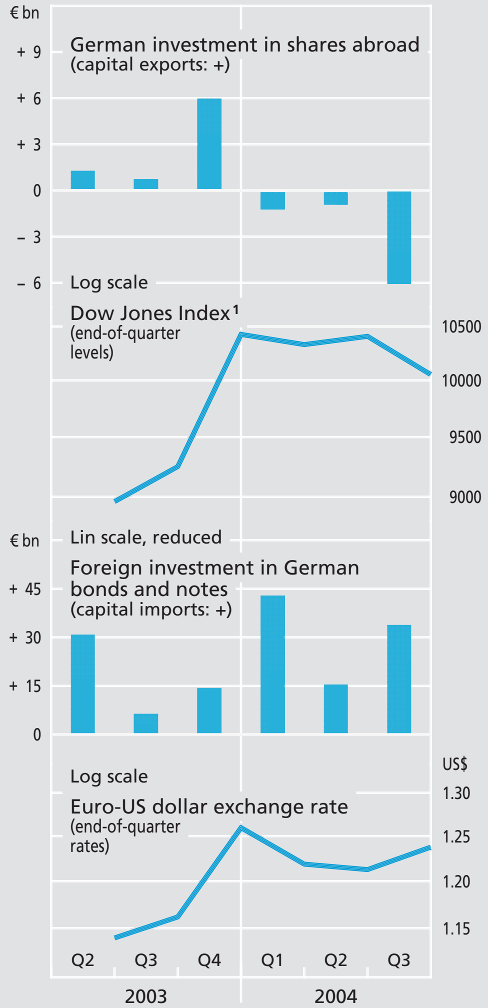
In contrast to portfolio investment, direct investment resulted in net capital outflows of €8½ billion in the three-month period under review. Between July and September German enterprises provided their branches abroad with funds totalling €8 billion net. The main reason for this was that German parent companies were paying back substantial amounts of loans which their subsidiaries abroad had previously granted them, ie reverse flows. By contrast, they reduced the equity capital which they held outside Germany.

Foreign direct investment in Germany

There was little change in the investment of foreign enterprises in Germany during the period under review (-€½ billion). Although these enterprises increased their equity capital in Germany by €3½ billion, this was largely due to a capital injection in the food, drinks and tobacco industry. At the same time, however, foreign proprietors withdrew funds (€4½ billion net) from their subsidiaries domiciled in Germany through intra-group credit transactions.

Investment behaviour and prices

Quarterly



1 2 October 1931 = 100; source: Reuters.

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Credit transactions of non-banks

The non-securitised credit transactions of non-banks were almost in balance in the third quarter (-€½ billion net). While the operations of general government resulted in net capital imports of €3 billion, enterprises and individuals transferred funds totalling €3½ billion abroad between July and September this year. This meant that they increased their claims on foreign banks while reducing their corresponding liabilities.

Credit transactions of the banking system

In the period under review the non-securitised credit transactions of the banks (including the Bundesbank), which usually represent, more or less, the counterpart of the other external transactions recorded in the balance of payments, resulted in net capital exports of €38 billion compared with €36 billion in the previous quarter. This quarterly result was due mainly to the external payments of the Bundesbank (-€33 billion), which were determined essentially by the increase in claims within the large-value payment system TARGET. There were likewise net capital exports (of €5 billion) in the case of the credit institutions between July and September.

Reserve assets of the Bundesbank

The reserve assets of the Bundesbank, which are shown separately from cross-border credit transactions in the balance of payments, declined by €1½ billion at transaction values between July and September. When these were valued at market prices, however, resultant valuation changes led to a rise in the reserve assets of €½ billion. The increase was attributable to price rises in the case of gold.