Foreign trade and payments

Foreign trade and current account

External environment

The external environment continued to improve for German trade and industry at the beginning of 2004. This was due mainly to the discernible economic upturn in the countries of trading partners outside the euro area; by contrast, economic activity in the euro-area countries was very much more subdued at the beginning of the year. Overall, the impetus exerted by foreign demand was so strong that German exports of goods rose by a seasonally adjusted 5½% in the first quarter of 2004 compared with the final quarter of 2003.

At the same time, the export expectations of German enterprises, which had already reached an optimistic level in the previous few months, improved further in April, a development which indicates that exports will continue to expand in the immediate future. This estimate is reinforced by the growth in export orders, which underwent a further slight expansion in the first quarter of 2004 after showing a relatively strong increase in the previous quarter (+½% seasonally adjusted). Evidently the retarding effects of the earlier appreciation of the euro, which have always taken some time to work their way through to exports, are not having any impact on the trend owing to the sustained global economic recovery. Certainly the appreciation-related pressure on German exports also declined somewhat recently. At the time this report went to press, the effective euro exchange rate was 3½% below its level at the beginning of the year.

Breakdown of exports

The powerful surge in demand for German products at the beginning of the year came mainly from trading partners outside the euro area. Exports of goods to non-euro-area countries rose on an average of January and February 2004 – regional and sectoral breakdowns of German foreign trade are not yet available for March – by 9½% compared with the fourth quarter of 2003. Yet again this illustrates the dominant role played by the growth of export markets in determining how Germany's external business fares. By contrast, changes in price competitiveness associated, for example, with the appreciation of the euro and the related disappearance of the temporary competitive edge on prices frequently tend to play a secondary role in a macroeconomic analysis. At all events, this assessment applies as long as the real exchange rate relationships do not fluctuate sharply.[1]

It was primarily the dynamic economic growth in Asia that stimulated the external turnover of German exporters at the beginning of the year. For example, exports to China rose by 27% and those to the emerging markets in South-East Asia by 17%. The cyclical upturn in Japan also led to a sharp increase in Japanese demand for German products (+9½%). Exports to Russia and the OPEC countries, whose income from the export of oil and gas has risen sharply, likewise increased rapidly (+24½% and +17% respectively). Even so, the importance of each of these two countries in relation to Germany's exports as a whole is relatively small. However, business with customers in the United States, which is much more extensive with a 9½% share of German exports and which in 2003 had still been suffering heavily from the

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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1 Owing to the appreciation of the euro, the price competitiveness of German enterprises vis-à-vis suppliers in countries outside the euro area deteriorated well into the first quarter of 2004. This was offset by the relatively favourable German price and cost developments within the euro area and – to a limited extent – by the recent exchange rate corrections. Although this means that, overall, the price competitiveness of German suppliers worsened, it was still fairly advantageous compared with the long-term average of the competition indicator up to the end of the period under review.

Trend in foreign trade by region and by category of goods

Average of January and February 2004 compared with the average of October to December 2003
%; seasonally adjusted

Item	Exports	Imports
Total	+ 5.6	+ 2.2
Selected country/group of countries		
Euro-area countries	+ 0.9	+ 3.5
Other EU countries	+ 1.5	+ 2.0
United States	+ 5.6	– 0.6
Japan	+ 9.6	+ 9.7
China	+ 27.2	– 3.5
Emerging markets in South-East Asia	+ 17.1	– 1.8
Russia	+ 24.4	– 6.3
OPEC countries	+ 17.1	+ 2.5
Categories of goods		
Selected main categories		
Intermediate goods	+ 10.3	+ 6.4
Capital goods	+ 2.8	– 0.7
Consumer goods	+ 6.7	+ 1.5
Energy sources	.	– 2.0
Selected categories		
Chemicals	+ 9.4	+ 14.6
Machinery	+ 11.4	+ 1.3
Motor vehicles and motor vehicle parts	– 5.0	+ 6.7
Information technology	+ 11.3	– 3.5

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strong appreciation of the euro against the US dollar, also increased significantly in the period under review (+5½%).

By contrast, German exports to the EU countries not participating in European monetary union grew more moderately (+1½%). This group of countries comprises not only Denmark, Sweden and the United Kingdom but since the EU enlargement of 1 May 2004 also the ten new member states.[2] Exports to the other euro-area countries, which had still been a mainstay of German foreign trade in 2003, likewise grew only slightly (+1%) in response to the no more than moderate expansion in euro-area economic output at the beginning of the year.

Almost the entire product range of German exporters benefited from the more buoyant foreign demand at the beginning of the year. For example, German exports of intermediate goods rose by 10½% in view of the increase in foreign output. Exports of chemicals increased sharply. Furthermore, the growing demand from foreign households resulted in a marked increase in the exports of German consumer goods (+6½%). Finally, the foreign demand for investment, which had still been fairly subdued in the previous year, increased discernibly in the first quarter of 2004. Subsectors of the German economy, where capital goods account for 45% of exports, also benefited from this. For example, German manufacturers of machinery as well as of information and communications technology products exported 11½% more in each case. However, the German motor industry, whose products are likewise classified as capital goods statistically, sustained a loss in export business. Consequently, only a moderate export increase (of 3%) was recorded in the case of capital goods as a whole.

Imports of goods

German imports of goods in the first quarter of 2004 were, in seasonally adjusted terms, 1½% above the level in the previous period. The main reason for the increase was German enterprises' greater demand for foreign intermediate goods owing to the expansion in output which was planned or which had al-

2 In order to preserve continuity in reporting, German foreign trade with these new EU countries has been classified under trade with the EU countries since the beginning of 2004. A more detailed account of the significance of the new member states for Germany's external relations appears in the article entitled "Effects of eastward enlargement of the EU on the German economy" on pp 5-22 of this *Monthly Report*.

ready taken place during the quarter concerned. In the case of the imports of intermediates, for example, there was a recorded increase of 6½% on an average of January and February (data for March are not yet available) compared with the final quarter of 2003. The increase in Germany's demand for imports was directed mainly at chemicals. Imports of motor vehicles and motor vehicle parts were also more buoyant. By contrast, imports of information and communications technology products were somewhat lower although they did start from the high level achieved in the final quarter of 2003. This was partially due to price reductions in this segment. Imports of energy also declined slightly but smaller volumes and falling prices for a time during the first few months of 2004 were contributory factors here.

The range of goods imported by German enterprises at the beginning of the year resulted in the business turnover with suppliers from other euro-area countries rising faster (+3½%) than business with manufacturers from outside the euro area (+1½%). Imports from Ireland, Finland and Austria increased particularly strongly. At the same time, the appreciation of the euro tended to depress the value of (euro-denominated) imports from the dollar zone. The decline in import turnover with this region is therefore not only a reflection of changes in volume. For example, German importers bought somewhat fewer goods from the United States in terms of value. After double-digit growth rates in the final quarter of 2003 suppliers in China and the emerging markets in South-East Asia likewise had to accept falling turnover

Major items of the balance of payments

€ billion

Item	2003 Q1	2003 Q4	2004 Q1
I Current account			
1 Foreign trade 1			
Exports (fob)	162.8	171.2	177.3
Imports (cif)	133.5	139.6	136.2
Balance	+ 29.3	+ 31.6	+ 41.1
2 Services (balance)	– 8.4	– 4.2	– 8.9
3 Factor income (balance)	– 4.7	+ 0.3	– 9.6
4 Current transfers (balance)	– 5.8	– 6.3	– 5.5
Balance on current account 2	+ 9.0	+ 19.5	+ 15.6
Memo item Balances, seasonally adjusted			
1 Foreign trade	+ 29.1	+ 32.6	+ 39.9
2 Services	– 8.4	– 7.7	– 9.1
3 Factor income	– 1.7	– 0.6	– 6.6
4 Current transfers	– 7.3	– 6.1	– 7.0
Current account 2	+ 10.0	+ 16.1	+ 15.5
II Balance of capital transfers 3	– 0.0	– 0.0	+ 0.4
III Balance of financial account 4	– 13.1	– 19.8	– 5.3
IV Change in the foreign reserves at transaction values (increase: –) 5	– 1.5	+ 1.2	+ 0.2
V Balance of unclassifiable transactions	+ 5.7	– 0.9	– 11.0

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 69. — **5** Excluding allocation of SDRs and changes due to value adjustments.

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with German enterprises. By contrast, imports from Japan grew strongly. Manufacturers in the other 13 EU countries not participating in European monetary union and in the OPEC countries also increased their sales on the German market.

Current account

The fact that the exports of goods expanded faster than the imports of goods in seasonally adjusted terms in the first quarter of 2004 ultimately led to a rise of €7½ billion in the German trade surplus to €40 billion. At the same time, the deficit on invisible current transactions with non-residents increased sharply in the first quarter of this year compared with its level in the final quarter of 2003. Larger cross-border net payments of factor income, which had risen quarter on quarter by €6 billion, were the main factor contributing to the growing deficit. The deficit on services also increased, and there was a marginal rise in net expenditure on current transfers. The outcome was a slightly reduced current account surplus of €15½ billion in the first quarter of 2004 compared with one of €16 billion in the previous quarter.

Financial transactions

Trends in financial transactions

In the first few months of 2004 the players on the international financial markets were caught between the opportunities afforded by the global economic upturn, on the one hand, and the – for a time – distinct uncertainty which prevailed as a result of the terrorist attacks in Madrid and the tensions in the Middle East, on the other. This was reflected in the (aforementioned) fluctuations in rates and yields on the international foreign exchange and capital markets. The shifting market views can also be seen to some extent in the figures on German financial transactions with non-residents. For example, net capital imports were recorded in portfolio investment during the first three months of this year whereas in the case of direct investment funds were exported. In the euro area as a whole, by contrast, the statistics so far available for the countries participating in European monetary union indicate net capital exports in both of these segments.

Portfolio investment

In the case of German portfolio investment, where, as a rule, portfolio adjustments are made very quickly in response to changed cyclical and risk assessment, net capital imports amounted to €10½ billion between January and March 2004 compared with net capital imports of €20½ billion in the final quarter of 2003.

Foreign investment in German securities

All in all, non-resident investors acquired German securities worth €36 billion in the quarter under review; between October and December 2003 they had already invested €31 billion in Germany. They also shifted their preferences significantly in the process. In the first quarter of 2004, for example, they spent €43½ billion on the purchase of German bonds and notes, which was discernibly more than in the earlier three-month period. Their purchases consisted of slightly more private bonds (€25 billion) than public bonds (€18½ billion). Non-residents were encouraged to invest in German debt securities not only because they expected that capital market yields would fall (and they would therefore make holding gains) but probably also to use them as a safe haven for their funds as a precautionary move. Just how much the demand for this paper is boosted by such motives in times of crisis can also be seen from the fact that the interest advantage of Federal bonds over similar paper issued by other euro-area countries increased by 8 basis points after the terrorist attacks in Madrid. Some of the funds used to acquire German bonds stemmed from the sale of German money market paper, ie from debt securities with a maturity of one year or less. Non-residents reduced their holdings of this paper by €11½ billion.

In the light of the relatively low share price level and the favourable profitability assessments of German public limited companies, foreign investors had acquired equities of German enterprises worth €20½ billion during the final quarter of 2003; in the first three months of 2004, however, they added only €3 billion worth of such paper to their portfolios. Contributory factors to this development were presumably not only the sluggish cyclical recovery in Germany but also the re-emergence of terrorist fears following the attacks in Madrid, which led to a discernible degree of uncertainty among investors and, at least for a time, to significant mark-downs on European and, particularly, German shares.

German investment in foreign securities

German residents invested more heavily in foreign securities markets at the beginning of 2004 (€25½ billion). As they have often been in the past few years, they were again particularly interested in bonds and notes (€26 billion net) and in foreign government bonds, especially those denominated in euro (€21½

Financial transactions

€ billion, net capital exports: –

Item	2003 Q1	2003 Q4	2004 Q1
1 Direct investment	– 0.9	– 11.9	– 14.4
German investment abroad	– 15.6	+ 1.1	+ 11.7
Foreign investment in Germany	+ 14.7	– 13.0	– 26.0
2 Portfolio investment	+ 34.7	+ 20.4	+ 10.3
German investment abroad	+ 5.7	– 10.7	– 25.6
Shares	+ 15.6	– 6.0	+ 1.3
Investment fund certificates	– 3.2	– 0.5	– 7.1
Bonds and notes	– 9.8	– 6.6	– 25.9
Money market paper	+ 3.2	+ 2.4	+ 6.1
Foreign investment in Germany	+ 29.0	+ 31.1	+ 35.9
Shares	– 3.4	+ 20.3	+ 2.8
Investment fund certificates	– 0.9	+ 0.3	+ 0.8
Bonds and notes	+ 17.7	+ 14.4	+ 43.8
Money market paper	+ 15.5	– 3.9	– 11.5
3 Financial derivatives 1	+ 2.4	– 0.0	– 1.4
4 Credit transactions	– 48.7	– 27.6	+ 1.2
Monetary financial institutions 2	– 32.9	– 30.2	+ 21.3
Long-term	– 14.5	+ 1.1	– 5.3
Short-term	– 18.4	– 31.4	+ 26.6
Enterprises and individuals	– 22.6	+ 11.0	– 10.1
Long-term	– 5.2	– 0.8	+ 2.1
Short-term	– 17.4	+ 11.9	– 12.1
General government	+ 1.8	– 0.2	– 3.0
Long-term	+ 4.3	+ 1.3	– 1.9
Short-term	– 2.5	– 1.5	– 1.1
Bundesbank	+ 4.9	– 8.2	– 7.0
5 Other investment	– 0.6	– 0.7	– 1.0
6 Balance of all statistically recorded capital flows	– 13.1	– 19.8	– 5.3
Memo item Change in the foreign reserves at transaction values (increase: –) 3	– 1.5	+ 1.2	+ 0,2

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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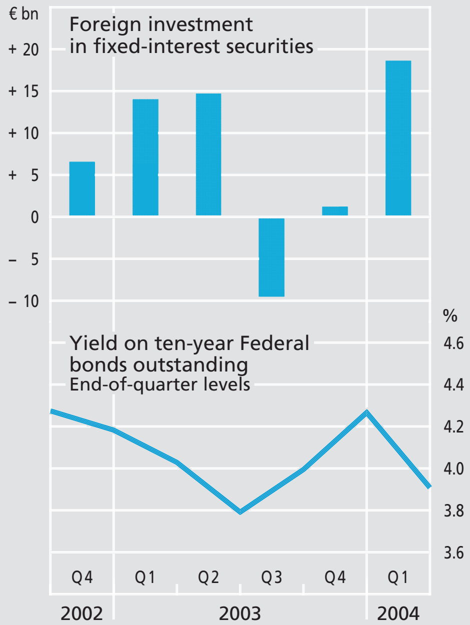
Foreign purchases of German bonds and notes, and interest rate movements



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billion). Their investment in foreign debt securities probably had something to do with the opinion of some market players – at the time – that bond market yields were still open to a certain downward revision, at least in the short term. However, a slightly greater amount of funds also accrued again to foreign institutional investors (€7 billion compared with €½ billion in the previous three months) whereas in the previous two years the funds flowing into these institutional investors had sharply declined. Part of the purchases of bonds and notes and of investment fund certificates issued by foreign borrowers was probably financed from the proceeds arising from the sale of foreign money market paper (€6 billion) and shares (€1½ billion) which German investors removed from their portfolios in the course of adjusting to the changes in underlying conditions.

Direct investment

The cross-border financial flows within conglomerates were determined in the first quarter of 2004 by the sale of an enterprise in the telecommunications sector. This transaction had an impact on both German direct investment abroad and, conversely, foreign direct investment in Germany. In contrast to events in portfolio investment, direct investment in this period resulted in net capital exports of €14½ billion compared with net outflows of €12 billion in the three months before.

German direct investment abroad

Between January and March German firms repatriated €11½ billion net, but it was only their cross-border participating interests – particularly in the EU and USA – that were reduced by this. Most of this reduction was due to the aforementioned corporate restructuring. A German group sold its participating interest in a subsidiary abroad. At the same time, however, German enterprises provided their foreign branches with new credit, with the result that a certain counterflow occurred.

Foreign direct investment in Germany

Substantial disinvestment also arose in the case of foreign direct investment in Germany during the period under review (€26 billion net). The main reason for this was that the German telecommunications enterprise used the sales proceeds to repay existing direct investment funds borrowed from an affiliated enterprise abroad. By contrast, foreign investors moderately increased their participating interests in Germany.

Credit transactions of non-banks

At a seasonally adjusted total of €13 billion, the net outflows of funds as a result of the non-securitised credit transactions of non-banks were fairly substantial at the beginning of the year. This outcome was due primarily to the operations (totalling €10 billion) of enterprises and individuals as they again stocked up their balances with foreign banks after reducing them at the end of 2003 – a customary practice at that time of year – for balance sheet purposes. A further €3 billion was exported during the period under review as a result of transactions by general government.

Credit transactions of the banking system

Between January and March 2004 net capital imports of €14½ billion arose through the non-securitised credit transactions of the banking system as a whole; in the previous quarter there had been net capital exports of €38½ billion. The decisive factor here was the sharp reduction in the (non-securitised) net external assets of the German monetary financial institutions (excluding the Bundesbank).[3] By contrast, there were outflows of €7 billion as a result of the Bundesbank transactions that are classified as credit transactions – primarily through settlements in the large-value payment system TARGET.

Foreign reserves of the Bundesbank

The foreign reserves of the Bundesbank remained almost unchanged – at transaction values – during the first three months of 2004. As both the price of gold and the exchange rate of the US dollar increased during the period under review, they amounted to €79½ billion – at market prices – at the end of March compared with €76½ billion at the end of 2003. Consequently, the valuation losses incurred in the previous quarter were more or less offset.

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3 In order to enhance the comparability of the various sets of statistics the term "monetary financial institution", which is already widely used in the banking statistics, will also be used in future in the balance of payments. This term covers not only the credit institutions and the Bundesbank but also the money market funds. It seems to be sensible to continue showing the credit transactions of the credit institutions and the money market funds separately from those of the Bundesbank, with the result that one would talk about "monetary financial institutions (excluding the Bundesbank)". The change in terminology does not create a statistical break because the non-securitised cross-border credit transactions of the money market funds were already classified under credit institutions.