Germany's balance of payments in 2012

Amid a challenging external environment, Germany's current account surplus grew distinctly in 2012 to 7% of gross domestic product (GDP), which was only slightly below its previous record high of 2007. On the export side, this rise was attributable to the German economy's ability to hold its own in markets outside Europe despite the significant slowdown in the pace of growth in 2012. This is partially due to the attractive product range offered by German exporters, although the euro's lower external value also played a role during the period under review. Germany's strong export performance vis-à-vis non-euro-area countries greatly outweighed the weak demand that its enterprises faced in the euro area.

The import side, too, contributed considerably to widening the current account surplus. In particular, the uncertainties emanating from the crisis in the euro area prompted German firms to hold back on their domestic investment, which adversely affected imports. While noticeable progress has been made in terms of correcting the current account imbalances within Europe, the 2012 surplus underlines the fact that, owing to the greater uncertainty it has engendered, the crisis has also hampered efforts to reduce the overall German current account surplus. The increased desire for safe investments has played a role in this. Safe-haven effects helped to boost the net inflow of investment income over and above the structural surplus which is generally generated thanks to Germany's high level of net external assets.

According to the recent data release, Germany's current account surplus has exceeded the threshold of 6% of GDP – which is a benchmark score under the EU procedure for the surveillance of macroeconomic imbalances – for more than five years now. In view of the determinants of this development, however, it would be inappropriate to take short-term measures to stimulate domestic demand in Germany. Instead, there is a need for political efforts geared to continuing the necessary adjustment processes in the crisis countries and creating a sustainable institutional architecture for monetary union as a whole. This would lead to a permanent reduction of uncertainty, which would help to lower the German current account surplus.

In 2012, Germany's financial account with the rest of the world was likewise chiefly influenced by the financial and sovereign debt crisis and the steps taken to alleviate it. Overall, the account recorded high net capital exports of €235 billion in 2012, most of which stemmed from public sector financial transactions. This was driven by a further increase in claims under the TARGET2 payment system together with government assistance to the programme countries. The portfolio investment account also saw capital outflows. The high demand for German government bonds was more than offset by countervailing transactions in other securities segments. Lastly, the direct investment sub-account – which is generally guided by longer-term considerations – likewise recorded a net capital outflow. Moves by German firms to further expand their presence abroad were the main reason for this.

Current account

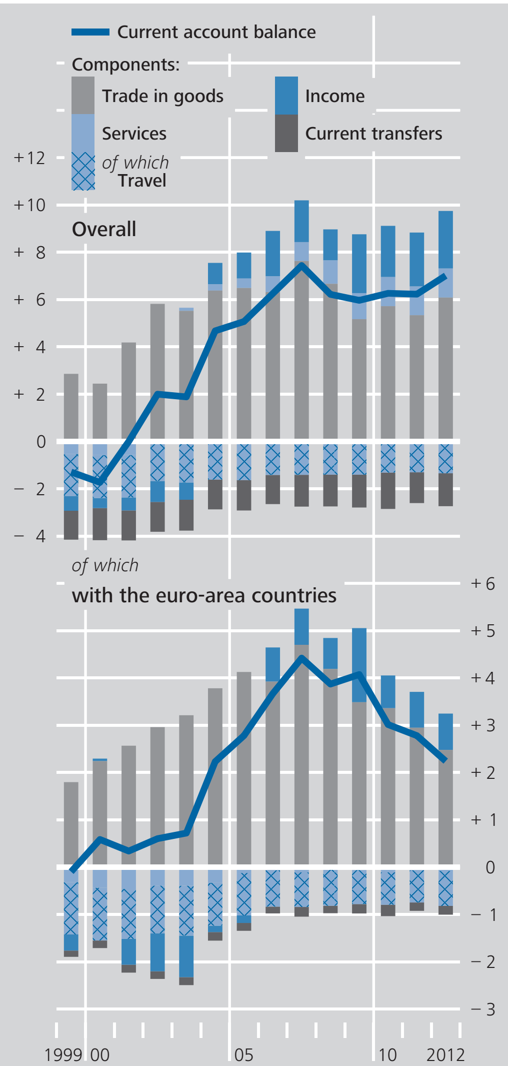
Underlying trends

Marked rise in current account surplus in 2012

Germany's current account surplus increased again in 2012. It rose by €24 billion during the period under review, which was considerably more than in the two preceding years. This three-year upturn completely reversed the contraction of the current account surplus that occurred in 2008 and 2009 in the wake of the severe recession. In absolute terms, the surplus stood at €185½ billion in 2012 and was thus slightly above its previous peak of 2007. In relative terms, the surplus amounted to 7% of GDP, which was ½ percentage point below its 2007 level.

Germany's current account

As a percentage of GDP



Deutsche Bundesbank

Growing importance of structural factors

Faced with a difficult global economic environment and lacking any discernible tailwind from global trade, German enterprises still performed well on foreign markets overall. This attests to their strong market position and attractive product range. Moreover, Germany's net foreign assets, which have meanwhile swelled to a volume of €1,000 billion, yielded a substantial income surplus. Both of these factors underline the strength of the German economy.

Effects of the financial and sovereign debt crisis …

The sovereign debt crisis in the euro area is affecting the German current account balance through various channels. The demand from euro-area partner countries for German goods and services clearly declined as a result of the severe recessions in some countries. This was the main reason for the sharp fall in Germany's current account surplus vis-à-vis its euro-area partner countries. The adjustment of current account positions within the euro area as a whole again made further progress last year.

… are manifold and countervailing

However, other effects which arose as the crisis escalated last year have hampered the correction of the German current account surplus. For instance, the crisis in the peripheral euro-area countries was doubtless partly responsible, via the uncertainty channel, for the restraint that prevailed among German investors. Through the related squeeze on investment in machinery and equipment, this affected a demand component which includes an above-average share of imports. An additional countervailing factor was the euro's lower external value, which made it easier for German firms to sell their goods in markets outside the euro area. The positive differential in cross-border investment income rose not just on account of the accumulated net foreign assets but also because of the widening yield spreads between domestic and foreign assets generated by safe-haven flows. The upsurge in the TARGET2 balance which was evident up to mid-2012 tended to lower cross-border investment income, inasmuch as it related to a reduction in interest-bearing claims on non-residents.

Goods flows and balance of trade

Big rise in trade surplus

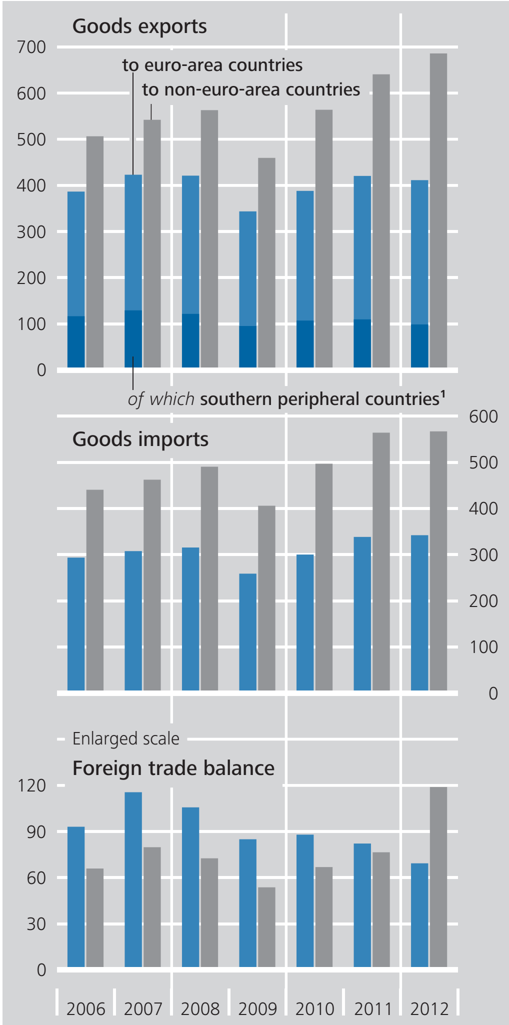
Germany's foreign trade momentum weakened considerably in 2012. Goods exports grew by a nominal 3½%, which was 8 percentage points less than in 2011. Goods imports were only slightly up on the year (+¾%), after having risen by more than one-eighth in 2011. Real imports are in fact likely to have shrunk during the year under review. During the same period, growth in external trade prices was relatively moderate on both the import and export side. Unlike in 2011 and 2010, when import prices increased considerably, no notable shifts occurred in the terms of trade in 2012. As a consequence, the sizeable surplus in volume terms was fully reflected in the trade balance. In 2012 the foreign trade surplus went up by €29½ billion to €188 billion, following significantly smaller increases in the two preceding years, which were greatly dampened by terms-of-trade effects.

Fall in goods exports to euro area …

The slowdown of global economic activity in 2012 was reflected in the reduced growth of goods exports, which came to a complete halt at the end of the year. The regional export pattern likewise tended to mirror the marked growth disparities in the various international markets in which German firms are active. In the euro area, the value of goods deliveries in 2012 was down on the year by 2¼%. This was mainly due to a fall of around one-tenth in demand for German products in the southern peripheral countries, which are undergoing severe recessions. The other euro-area countries, which are having to deal with the negative cyclical fallout of the sovereign debt crisis, could not offset this decline, even though exports to France rose by 3%. However, it should be noted that, statistically, this rise was solely attributable to shipments of goods associated with Franco-German aerospace joint ventures, which shot up by more than one-third.

Germany's foreign trade within and outside the euro area

€ billion



1 Italy, Spain, Greece, Portugal, Cyprus.
Deutsche Bundesbank

… but further marked rise in goods exports to non-euro-area countries

By contrast, exports of goods to non-euro-area countries rose significantly in 2012. Revenue from this area went up by 7%, though this was only half the 2011 growth rate. However, given the pronounced slowdown in the pace of growth in markets outside the euro area, German exports held up very well. Efforts to attract and retain customers – in what was a challenging economic environment – also by means of price concessions were aided by the sharp drop (up to the turning point in mid-2012) in the euro's nominal effective exchange rate, which

Foreign trade by region

%

Country/ group of countries	Percentage share 2012	Annual percentage change 2010	2011	2012
Exports				
Euro area (17)	37.5	12.9	8.4	– 2.2
Other EU countries	19.5	16.5	13.3	3.4
of which				
United Kingdom	6.6	10.2	11.8	10.1
Central and east European EU countries (7) 1	9.6	20.3	15.6	1.0
Switzerland	4.4	17.3	14.9	2.0
Russia	3.5	27.8	30.8	10.4
USA	7.9	20.6	12.5	17.7
Japan	1.6	20.9	15.0	13.1
Newly industrialised economies in Asia 2	2.9	33.4	8.8	4.3
China	6.1	44.3	20.6	2.7
South and east Asian emerging market economies 3	2.4	24.0	12.3	11.0
OPEC	2.7	13.7	– 2.0	18.1
All countries	100.0	18.5	11.5	3.4
Imports				
Euro area (17)	37.6	16.0	12.7	1.1
Other EU countries	18.5	18.6	15.8	0.6
of which				
United Kingdom	4.8	16.9	18.0	– 2.7
Central and east European EU countries (7) 1	10.9	21.2	15.8	3.0
Switzerland	4.1	15.7	13.8	1.8
Russia	4.7	26.4	28.4	3.8
USA	5.6	15.2	7.3	4.2
Japan	2.4	18.6	5.0	– 7.5
Newly industrialised economies in Asia 2	2.4	41.3	– 4.5	– 6.2
China	8.5	36.3	2.9	– 2.8
South and east Asian emerging market economies 3	3.1	31.9	13.8	– 0.7
OPEC	1.9	19.4	42.8	26.9
All countries	100.0	19.9	13.2	0.7

1 Bulgaria, Czech Republic, Hungary, Latvia, Lithuania, Poland, Romania. **2** Hong Kong, Singapore, South Korea, Taiwan. **3** India, Indonesia, Malaysia, Philippines, Thailand, Vietnam.
Deutsche Bundesbank

for a time sank to around 7% below its 2011 average. This is consistent with the comparatively large expansion in goods exports to the United States, Canada, Japan and the United Kingdom. The rise in exports of goods to Asia (excluding Japan) in 2012 fell short of the rates recorded in 2011 and 2010. This was probably mainly due to the cooling macroeconomic conditions in China. Sales to that country rose by a mere 2¾%, following increases of one-fifth and more than two-fifths in 2011 and 2010 respectively. By contrast, exports to the energy-rich OPEC nations, as well as to Russia and Norway, flourished, whereas exports to central and east European EU member states grew only moderately during the period under review.

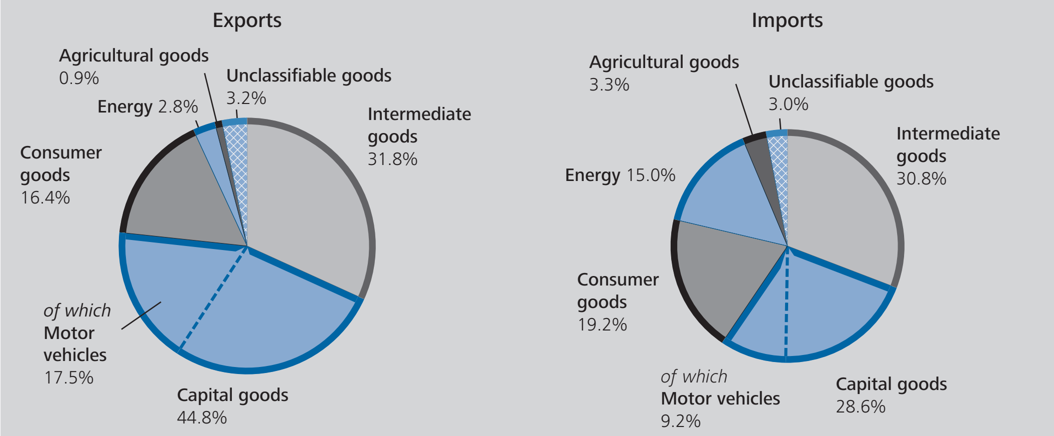
Capital goods still in high demand abroad, …

In 2012, capital goods made in Germany were in higher demand than one year earlier, led by exports of aircraft and spacecraft as well as of computers, electronic and optical products and electrical equipment. Manufacturers of machinery and equipment, however, had to content themselves with a small increase in foreign sales. Conversely, exports of consumer goods rose markedly during the period under review, primarily on account of strong demand for pharmaceutical products. Overall, motor vehicle exports increased only moderately in 2012, albeit with clear regional differences. Automobile groups sold record numbers of vehicles, in particular, in the USA, Russia and China, while sales within the euro area continued to fall perceptibly. Foreign sales of intermediate goods expanded only marginally during the reporting period owing to their relatively strong dependence on global industrial activity, which was particularly hard hit by the prevailing cyclical slowdown.

… but not in Germany of late

Imports were clearly affected by investors' restraint, which was reflected *inter alia* in a declining volume of imported machinery and sluggish growth in imports of information and communication technology (ICT). Imports of consumer goods continued to grow moderately in line with the modest upward trend in private consumption. Demand for imported

Foreign trade by selected categories of goods in 2012



Deviations from 100% due to rounding.
Deutsche Bundesbank

intermediate goods (excluding energy products) in 2012 was no higher than in 2011. Energy imports rose by one-eighth in terms of value. While this rise was largely attributable to a renewed significant increase in import prices, the volume of energy acquired from abroad also grew distinctly. This primarily benefited Norway and the OPEC countries, but also Russia to some degree. Overall, the regional breakdown of imports showed much less diversity than that of exports. This is not just a reflection of the German economy's strong links with other countries in international value chains but also a result of long-standing supplier relationships which are also comparatively resistant to exchange rate fluctuations.

Breakdown of invisibles

Services deficit virtually unchanged

Last year, revenue from and expenditure on cross-border service transactions both went up by around 7%, which was a somewhat larger increase than in 2011. On balance, the services deficit expanded marginally to €3 billion in 2012. The large sums of money customarily spent by German residents on foreign travel were not the sole reason for this widened deficit. An additional factor was the smaller surplus earned from business-related services, whereas financial services generated a distinctly higher positive result.

Growth in service flows well down in some cases

The slowdown in industrial activity had a strong impact on cross-border services, which are closely associated with the production and distribution of goods. Transport transactions were particularly hard hit, with revenue and expenditure growing by only 3% in each instance. By contrast, services indirectly connected with production activity continued to expand robustly, and domestic providers of research and development (R&D) services, ICT applications and business-related services met with buoyant foreign demand. Similarly, non-resident firms greatly upped their provision of such services in Germany. With respect to the individual net balances, there are certain specialisation tendencies in the R&D segment that are favouring a German surplus, whereas foreign providers are becoming increasingly dominant in the commercial services segment.

Ongoing shift in construction activity towards Germany

Persistently buoyant construction demand prompted German building firms to continue to concentrate their production capacity more on Germany. As a result, revenue from construction work, assembly and repairs carried out abroad fell by €1 billion in 2012 after already having decreased by €2 billion over the preceding three years.[1] Foreign construction firms likewise reaped additional gains from strong domestic demand. Expenditure on construction work provided by foreign firms rose by almost half, albeit from a very low baseline. Moreover, expenditure on cross-border engineering and other technical services saw a further large increase. Given the only marginally improved revenue situation, this component ceased to run a surplus for the first time in ten years.

Larger surplus in financial and insurance business

In 2012, income from cross-border financial and insurance services increased by a comparatively moderate 2½%. In stark contrast to the result in 2011, expenditure in this sector declined substantially by one-eighth during the reporting period. The surplus generated by bank commission income and insurance fees expanded by close to €2 billion last year.

Further clear rise in private travel expenditure, …

German residents' expenditure on foreign travel rose by almost 6% in 2012,[2] which outstripped the already substantial increase of around 5% seen in 2011. This was primarily driven by German residents' evidently strong propensity to spend, fuelled not least by their continuing high income expectations, which was also mirrored in their foreign travel budgets. Private travel expenditure went up by almost 7%, mainly owing to a higher use of travel services related to foreign vacations and individual visits.[3] This contrasted with spending on business trips, which shrank by 2% in 2012 after having already fallen by 4% in 2011. Looking at the period of economic recovery as a whole since 2010, it is striking that expenditure on business travel is still falling far short of the pre-crisis levels. This is presumably due to cost-cutting measures by many enterprises which adjusted their business travel guidelines during the 2009 recession.

… thus benefitting euro-area countries

Spending by German tourists and business travellers in other euro-area countries rose at a well above-average rate (+6½%). Among the Mediterranean countries, Italy and France were the main beneficiaries of this greater readiness to spend. In Spain, however, travel expenditure stagnated, while in Greece it experienced a steep decline. Following a temporary upturn in travel to Greece in 2011, the country's increasingly tense political and economic situation clearly deterred many potential visitors last year. By contrast, the boom in travel to destinations in Turkey, Croatia and Bulgaria persisted. Furthermore, more German residents returned to holidaying in Egypt and Tunisia during the reporting period after visitor numbers had plummeted in 2011 because of the political unrest. Following a sharp fall in 2011, spending on travel to Switzerland was down slightly again in 2012, which in large part was probably due to the Swiss franc's persistent strength against the euro. To a certain extent, tourists traditionally favouring Switzerland as a holiday destination are likely to have chosen to visit resorts in Austria instead. However, this only partially explains the large 6% increase in spending on travel to this destination. Long distance travel to America and Asia gained greatly in popularity in 2012 compared with 2011.

Travel deficit widens appreciably

The turnover generated by domestic hotels and restaurants with non-residents continued to develop strongly in 2012, growing by 6%. Even so, the negative net balance of expenditure on and income from travel activity widened by almost €2 billion to €35½ billion in 2012.

Surplus on investment income well up

The surplus earned from cross-border investment income in 2012 was up by €5½ billion, which was caused by a decline on the expenditure side. The fact that Germany's investment income account meanwhile shows a sizeable surplus (€62½ billion during the reporting

1 This relates to gross flows. The current account, however, shows only net flows, ie after deducting expenditure on goods and services provided by local subcontractors.
2 Alongside vacation travel, this category includes business trips, private visits and shopping trips, journeys for educational and health reasons and excursions not involving an overnight stay.
3 Individuals' propensity to spend more money on travel was not confined to foreign destinations. For example, according to data contained in the accommodation statistics, there was also a 2¾% rise in the number of overnight stays in Germany by residents, which was a similar rise to that seen in 2011.

period) is attributable to the continuous build-up of its external net asset position over the past decade and a half. Nevertheless, total revenue in 2012 did not quite match the prior-year figure; it was particularly dampened by lower interest payments from cross-border lending. Earnings from portfolio investment abroad remained virtually unchanged in 2012, while earnings from direct investment were slightly up on 2011. Domestic borrowers paid almost 5% less interest on investments by non-residents in 2012 than one year earlier. Expenditure on servicing loans declined sharply. In addition, issuers of securities paid much lower dividends to non-residents. On the other hand, the latter obtained higher yields on their direct investments in Germany than in 2011. Labour income, which plays a minor role compared with investment income, recorded only a small year-on-year increase in both revenue and expenditure.

Larger deficit on current transfers

Current transfers to the rest of the world amounted to €55½ billion in 2012. This exceeded the previous year's total by €2 billion, mainly due to larger transfers to the European Union. By contrast, the value of corresponding transfers from the rest of the world to resident recipients fell by €1 billion to €19 billion. This decline was chiefly connected with lower net income from tax transfers which, however, had increased quite strongly in 2011. On balance, the deficit on current transfers widened to €37 billion during the reporting period. The public sector accounted for nearly two-thirds of this deficit which, as usual, mainly arose from net transfers to the EU budget.

Financial transactions

In 2012, Germany's current account surplus was again mirrored by high net capital exports

Major items of the balance of payments

€ billion

Item	2010	2011	2012
I Current account			
1 Foreign trade[1]			
Exports (fob)	952.0	1,061.2	1,097.3
Imports (cif)	797.1	902.5	909.1
Balance	+ 154.9	+ 158.7	+ 188.3
Supplementary trade items[2]	− 12.4	− 20.5	− 27.3
2 Services (balance)	− 2.1	− 2.3	− 3.1
of which Travel (balance)	− 32.8	− 33.8	− 35.6
3 Income (balance)	+ 53.9	+ 59.0	+ 64.4
of which Investment income (balance)	+ 52.3	+ 57.1	+ 62.4
4 Current transfers (balance)	− 38.3	− 33.7	− 36.8
Balance on current account	+ 156.0	+ 161.2	+ 185.4
II Balance of capital transfers[3]	− 0.6	+ 0.7	+ 0.0
III Financial account[4]			
1 Direct investment	− 48.4	− 2.3	− 47.0
2 Portfolio investment	− 124.0	+ 27.0	− 65.7
3 Financial derivatives	− 17.6	− 27.5	− 17.9
4 Other investment[5]	+ 51.5	− 156.9	− 103.0
5 Change in the reserve assets at transaction values (increase: –)[6]	− 1.6	− 2.8	− 1.3
Balance on financial account[7]	− 140.1	− 162.6	− 234.9
IV Errors and omissions	− 15.3	+ 0.7	+ 49.4

1 Special trade according to the official foreign trade statistics (source: Federal Statistical Office). From January 2007 onwards, excluding supplies of goods for/after repair/maintenance which, up until December 2006, were deducted via supplementary trade items. **2** Including warehouse transactions for the account of residents and the deduction of goods returned. **3** Including the acquisition/disposal of nonproduced non-financial assets. **4** Net capital exports: –. For details see the table "Financial transactions" on p •. **5** Includes financial and trade credits, bank deposits and other assets. **6** Excluding allocation of SDRs and excluding changes due to value adjustments. **7** Balance on financial account including change in the reserve assets.
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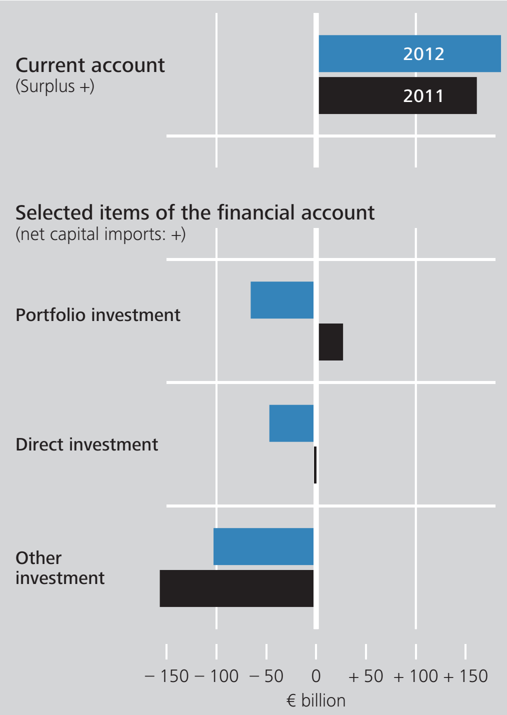
Major items of the German balance of payments

Balances



Deutsche Bundesbank

High net capital exports in financial transactions

(€235 billion).[4] Just under half of this sum was attributable to other investment. The Bundesbank's accumulating claims under the TARGET2 large-value payment system were once again a crucial factor in this. Additional capital outflows occurred *inter alia* in the portfolio investment and direct investment accounts.

Capital flows influenced by sovereign debt crisis

In 2012, Germany's financial account with the rest of the world was again much affected by the sovereign debt crisis in several euro-area countries and the steps taken to alleviate it. Market activity was initially dominated by lingering concerns among market participants about the economic outlook in the euro area and doubts about the willingness of some member states to carry on reforming, which led *inter alia* to sharply widening government bonds spreads within the euro area. In the second half of the year, the Eurosystem's nascent Outright Monetary Transaction (OMT) bond purchase programme, together with the decisions regarding the establishment of a single supervisory mechanism (SSM) for banks under the aegis of the European Central Bank, served to calm the markets. Added to this, the crisis countries made visible progress towards improving their external position. On balance, financial transactions to and from Germany were partly influenced by countervailing developments during the fairly turbulent first six months of 2012 and the calmer second half of the year.

Portfolio investment

Swing in portfolio investment

Amid a persistently very low turnover level on account of the crisis, portfolio investment, which as a rule is particularly quick to react to changes in sentiment on the financial markets, saw net capital exports amounting to €65½ billion last year, compared with net capital imports of €27 billion in 2011.

Domestic investment in foreign debt securities, …

The swing in portfolio investment was predominantly attributable to a marked lift in German investment abroad. Domestic investors purchased foreign securities worth €108 billion net (2011: €22½ billion), with a particular emphasis on interest-bearing paper. German investors' demand for fixed-interest securities from the rest of the euro area picked up again after plummeting in 2011; this led to net purchases in excess of €37 billion in 2012. Given the considerably reduced yields available in Germany, institutional investors, in particular, demonstrated a growing interest in euro-area debt securities. Above all, there was a strong demand in Germany for bonds issued by the European Financial Stability Mechanism (EFSF) (€23½ billion).

… in foreign currency bonds …

By contrast, purchases of foreign currency bonds issued by non-residents were very limited (€6 billion). Net demand was strongest for

4 The difference between the balances of the current account and the financial account is primarily attributable to the comparatively high level of errors and omissions (€49½ billion).

securities denominated in Danish krone and Swiss francs. Acquisitions of bonds denominated in US or Australian dollars, which had dominated purchasing activity in 2011, amounted to less than €½ billion in each case after deducting the corresponding sales.

… and in foreign shares and mutual fund units

Prompted by declining risk aversion, domestic investors showed a growing interest in foreign shares. They purchased equities worth €11 billion net in 2012, after offloading foreign shares on balance in 2011. The comparatively favourable share price trend prevailing in many foreign stock markets is likely to have contributed to this turnaround. This is also underlined by the regional breakdown of share purchases. All in all, investors sought to acquire shares in companies domiciled outside the euro area, which were less affected by the crisis within the euro area. Conversely, Spanish and Italian shares were sold on balance.

Aside from direct exposures to foreign equities, indirect investment in equities through foreign investment (asset management) companies probably also played a key role. In any case, across 2012 as a whole, German investors purchased foreign mutual investment units to the tune of €21½ billion after close to balanced sales and purchases of these instruments in 2011.

Foreign investment in domestic public debt securities, …

In the reverse direction, foreign investors acquired German securities worth just over €42 billion in 2012, which was slightly less than in 2011. However, at a volume of €79 billion, purchases of public debt securities – €27 billion worth of which were issued by resolution agencies – once again exceeded the already high net volume of such purchases in the preceding years of the crisis. This underscores how, in view of the further sovereign downgrades of other countries by the big rating agencies, the search for safe havens remained a key criterion for foreign investors. The full-year outcome described above is, however, wholly attributable to the buoyant purchasing activity seen in the first five months of 2012, which then lost much of its steam in the second half of the year.

Financial transactions

€ billion, net capital exports: –

Item	2010	2011	2012
1 Direct investment	– 48.4	– 2.3	– 47.0
German investment abroad	– 91.8	– 37.5	– 52.1
Foreign investment in Germany	+ 43.4	+ 35.2	+ 5.1
2 Portfolio investment	– 124.0	+ 27.0	– 65.7
German investment abroad	– 171.3	– 22.7	– 108.0
Equities	– 1.4	+ 2.1	– 11.2
Mutual fund shares	– 21.6	– 1.8	– 21.6
Bonds and notes[1]	– 154.5	– 18.0	– 75.9
Money market instruments	+ 6.1	– 4.9	+ 0.7
Foreign investment in Germany	+ 47.3	+ 49.6	+ 42.3
Equities	– 6.1	– 11.4	+ 1.1
Mutual fund shares	+ 3.6	+ 6.6	– 3.9
Bonds and notes[1]	+ 59.6	+ 50.3	+ 52.9
Money market instruments	– 9.8	+ 4.1	– 8.0
3 Financial derivatives[2]	– 17.6	– 27.5	– 17.9
4 Other investment[3]	+ 51.5	– 156.9	– 103.0
Monetary financial institutions[4]	+ 214.7	– 52.6	+ 113.7
Long-term	+ 71.8	– 31.3	+ 37.6
Short-term	+ 142.9	– 21.3	+ 76.1
Enterprises and households	– 57.4	+ 4.4	– 5.1
Long-term	– 47.7	– 6.7	– 11.4
Short-term	– 9.7	+ 11.1	+ 6.3
General government	+ 36.3	– 2.5	– 78.9
Long-term	– 46.9	+ 2.9	– 11.9
Short-term	+ 83.2	– 5.4	– 67.0
Bundesbank	– 142.1	– 106.1	– 132.7
5 Change in the reserve assets at transaction values (increase: –)[5]	– 1.6	– 2.8	– 1.3
Balance on financial account[6]	– 140.1	– 162.6	– 234.9

1 Original maturity of more than one year. **2** Securitised and non-securitised options and financial futures contracts. **3** Includes financial and trade credits, bank deposits and other assets. **4** Excluding Bundesbank. **5** Excluding allocation of SDRs and excluding changes due to value adjustments. **6** Balance on financial account including change in the reserve assets.

Deutsche Bundesbank

… in domestic private debt securities, …

Unlike in the case of public debt securities, cross-border trading in private bonds and notes resulted in net sales and redemptions over the year as a whole (€26 billion). Foreign investors' restraint in acquiring German private bonds with an original maturity of over one year was, however, not just demand-related but also supply-driven. Structural factors are partly behind this. For example, the outstanding volume of bank debt securities issued by residents has been waning for several years. Last year alone, this figure declined by around €100 billion.

… in domestic money market paper …

International investors also made net disposals of domestic money market paper (€8 billion). However, as with bonds, they drew a clear distinction between public and private issues. Hence, money market paper issued by the Federal government remained very much in demand, whereas privately issued instruments were offloaded by foreign investors (or redeemed) on balance.

… and in domestic shares and mutual fund units

Cross-border turnover in German shares receded in 2012 as a result of the crisis. Seen over the year as a whole, foreign investors purchased German equities for €1 billion net. However, this contrasted with an outflow of foreign capital from German mutual funds amounting to just under €4 billion. As a consequence, the capital flow trends recorded in these two segments in 2011 underwent a complete reversal in 2012.

Financial derivatives showing net capital exports

Financial derivatives (which are aggregated to form a single item in the balance of payments) showed net capital exports, as in the two preceding years. At €18 billion, the 2012 outflow was somewhat lower than the prior-year level, however.

Direct investment

Direct investment worldwide …

The financial and sovereign debt crisis, which has now been going on for several years, is clearly impinging on the direct investment account as well. After expanding by one-sixth in 2011, global foreign direct investment (FDI) inflows declined by 18% to US\$1½ trillion last year according to UNCTAD estimates.[5] UNCTAD attributes this to macroeconomic fragility and policy uncertainty for investors. The impact consequently varied according to country group and region. The developed countries saw a drastic decline in inward direct investment, with a majority of the euro-area countries experiencing particularly sharp falls. By contrast, foreign direct investment flows to the emerging and developing economies, which are at most only indirectly affected by the crisis in Europe and whose growth prospects are comparatively favourable, were only marginally down. On balance, the level of direct investment in developing countries surpassed inward FDI in the developed economies for the first time, according to UNCTAD data.

… and in Germany

The cross-border direct investment activities of German enterprises abroad and those of non-resident enterprises in Germany developed along different lines in 2012. While German companies increased their foreign direct investment compared with 2011, foreign investors markedly reduced their investment in Germany. All things considered, direct investment flows to and from Germany resulted in net capital outflows of €47 billion in 2012.

Clear rise in German direct investment abroad

The net outflow was primarily due to the cross-border activities of companies domiciled in Germany. While the magnitude of their foreign investment (€52 billion) surpassed the 2011 figure, it was still well below the volume recorded in 2010. On the one hand, domestic enterprises supplied their foreign subsidiaries with additional equity capital and strengthened their capital base by reinvesting earnings. On the other hand, German parent companies saw capital inflows in the form of intra-group credit transactions, whereby they borrowed on a large scale from their foreign affiliates (reverse flows).

The rising level of direct investment – also during the crisis – underlines the significance for German firms both of foreign business and of maintaining a market presence abroad. In a survey conducted by the Association of German Chambers of Commerce and Industry (DIHK) investigating the motives behind foreign investment, almost half of the respondent companies in 2012 specified the promotion of marketing and customer services as the driving

5 See United Nations Conference on Trade and Development, 2012, Global Investment Trends Monitor, No 11, 23 January 2013.

Acquisition of real estate by non-residents in Germany

Non-residents' acquisition of German real estate has recently been a recurring central topic of public debate. This has led to the impression that non-residents have been buying more and more property, especially in urban centres. The cross-border acquisition of real estate is captured statistically in the German balance of payments. The available data do not support the assertion that buyers from other countries have stepped up their activities, however. Last year, non-resident owners[1] reduced their real estate portfolio by more than €0.8 billion net. Recorded purchases of €0.7 billion contrasted with sales of just under €1.6 billion. This means there was no qualitative change in the situation compared with the previous year. In 2011, too, sales outweighed purchases (by €0.1 billion).

This was not always the case in the past. From 2006 to 2008, non-residents bought real estate in Germany on a major scale. Acquisition peaked in 2007 at €8.6 billion net. This involved transactions that were small in number, but on a very large scale. This was due, for one thing, to the privatisation of public housing stocks. For another, this period saw the sale of one big retail enterprise's properties to a foreign asset management company. Within the same period, the 25 largest transactions alone accounted for almost two-thirds of the real estate acquired.

A look at the regional distribution of the (direct) buyers of real estate in Germany shows that most of them come from other countries in Europe. In this context, Luxembourg and the Netherlands traditionally play a significant role, not least as a result of transactions by the mutual funds and holding companies domiciled there. Lately, there has been a moderate rise in purchases, from Russia and China in particular. For some years now, investors from the United States have been selling more than they have bought. For the United Kingdom and Denmark, this has been the case since 2008 and 2009 respectively.

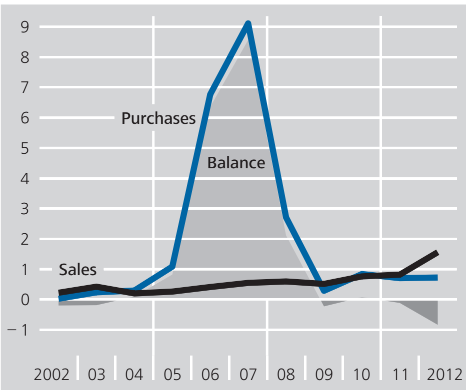
All things considered, the volume of cross-border real estate transactions recorded in the balance of payments has been rather small compared with the value of the stock of German real estate or the annual turnover of this sector. According to the overall balance sheet, the value of all real estate in Germany in 2011 amounted to €9.8 trillion,[2] and sales on the German property market at the end of the period under review amounted to roughly €148 billion.[3] The share of purchases by non-residents was therefore just under ½% in mathematical terms.

Caution is nevertheless warranted in interpreting this figure. Specifically, there are a number of points in connection with the recording of the balance of payments statistics that have to be taken into consideration. For example, the acquisition of real estate by a non-German citizen residing in Germany or by an enterprise located in Germany, which is itself in foreign ownership, is deemed to be a domestic transaction and is not entered into the balance of payments. Actual cross-border acquisition of property is indeed to be reported by the resident buyer or seller from an exemption limit of €12,500 upwards. Despite this low reporting threshold, however, purchases (and sales) of real estate by non-residents are

1 The deciding criterion, as in the balance of payments generally, is the buyer's or seller's place of residence or where the enterprise is officially registered, not their nationality.
2 Residential property, public and commercial real estate as well as building land.
3 According to data from the report on the real estate market in 2011 by the working group of senior committees of surveyors in the Federal Republic of Germany. See Arbeitskreis der Gutachterausschüsse und Oberen Gutachterausschüsse in der Bundesrepublik Deutschland, Immobilienmarktbericht 2011 (available in German only). The data on sales relate to 2010.

Acquisition of real estate by non-residents in Germany

€ billion



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probably underreported in the data as the agencies responsible for collecting the data are scarcely able to identify instances of failure to submit a report, especially in the case of resident private individuals. As a rule, the Bundesbank is able to ascertain failure to comply with the reporting requirement only in the case of large-scale transactions (by means of press analyses), while conducting separate examinations of the business activity of large reporting bodies (banks, mutual funds, insurers) or in the context of plausibility studies (comparing rent payments to non-residents with the reported purchases). For any additional measures to improve data quality, the Bundesbank is reliant upon the voluntary cooperation of others. To close the reporting gaps, it would be helpful if fulfilment of the reporting requirement could be made part of the notarised documentation process, for example.

Against this background, the now currently available data on non-residents' purchases and sales of domestic real estate for 2012, as well of those of the past few years, should be regarded as the lower limit for the transactions that actually took place.

factor.[6] While this objective gained in importance compared with 2011, German enterprises were warier of the costly business of establishing production plants outside Germany. Of late, the acquisition of foreign enterprises played only a minor role in the expansion of German direct investment abroad.[7]

Regional and sectoral breakdown

In 2012, German direct investment abroad was mainly concentrated on the industrial countries, which accounted for more than two-thirds of the total volume. This focus contrasted with the situation in 2011, when the emerging and developing countries were the main target. In the period under review, German direct investors' interest within the euro area was primarily focused on the Netherlands and Luxembourg. Both of these countries are major locations of international holding companies, meaning that the funds invested there do not have to remain within those countries' national borders. Within Europe, additional investment was channelled to the United Kingdom. Outside Europe, China was the most sought-after investment location. In terms of volume, German private equity companies proved to be the biggest investors in 2012, followed by the financial sector.

Foreign direct investment in Germany

Unlike German proprietors, non-resident investors sharply scaled back their net direct investment in Germany from €35 billion in 2011 to €5 billion in 2012. This drop reflects the global downturn in direct investment in the industrial economies that was described at the beginning of this section, although this is surprising in Germany's case because its economy has fared relatively well compared with the rest

6 See DIHK, Auslandsinvestitionen in der Industrie – Frühjahr 2012, March 2012.
7 According to data from Thomson One (Thomson Reuters), German enterprises' cross-border merger and acquisition (M&A) activity saw a year-on-year decline from €22½ billion in 2011 to €15½ billion in 2012. This relates to completed M&A deals in which the purchaser owns 10% or more of the shares in the target enterprise after the transaction.

of Europe. While disinvestments and disposals lowered the amount of equity capital in foreign-owned German enterprises, reinvested earnings served to bolster their capital base.

Regional and sectoral breakdown

The financial funds channelled to German enterprises predominantly came from parent companies in the United States, France and the Netherlands, and in each case were almost exclusively provided via intra-group credit transactions. Conversely, primarily investors based in Belgium and the United Kingdom withdrew direct investment from Germany on balance, with a strong focus on liquidating equity holdings. While German subsidiaries in the financial sector were supplied with additional funds, the domestic affiliates of foreign chemical companies were particularly affected by capital withdrawals.

Other investment

Other investment showing net capital exports

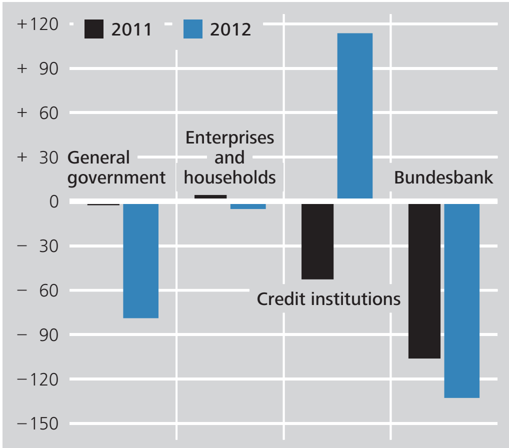
Other investment, comprising financial and trade credits (where these do not constitute direct investment) as well as bank deposits and other assets, saw net capital exports of €103 billion in 2012. However, the overall figure masks completely divergent developments in the first and second half of the year: while the January-June period (excluding the change in TARGET2 balances) resulted in massive net capital imports owing to the high level of uncertainty on the international financial markets, sizeable outflows of funds to the rest of the world occurred during the ensuing six months. In each case the TARGET2 balances moved in the opposite direction.

Non-banks

The cross-border transactions of domestic non-banks generated net capital outflows amounting to €84 billion in 2012. Government entities, which accounted for €79 billion of this total, mainly increased their long and short-term external claims, but they also reduced their external liabilities. The increase in claims was largely triggered by loans extended to Greece and, to a lesser extent, to Portugal and Ireland by the EFSF as well as by the increase in funding for the European Stability Mechanism (ESM), which was executed in two tranches. The decline in external liabilities was attributable in no small part to transactions executed by FMS Wertmanagement, a public resolution agency.[8] Enterprises and households recorded additional capital exports totalling €5 billion. This owed much to the increase in external assets of one

Other investment broken down by sector

Balances in € billion



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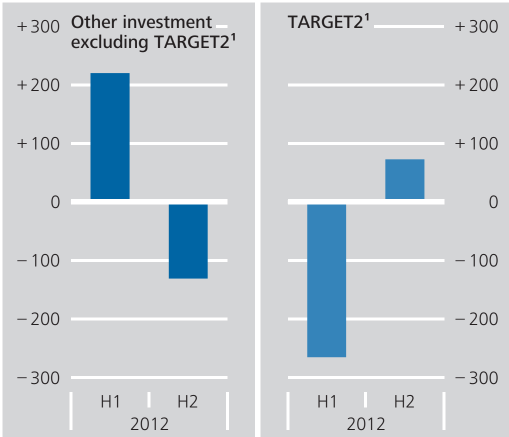
Shift in other investment

€ billion



1 Change in TARGET2 balance.
Deutsche Bundesbank

8 Loans granted by the EFSF to the programme countries are booked in the German balance of payments as an increase in government claims on these countries, relative to Germany's share in this financial assistance. However, this entails a simultaneous increase in Germany's external liabilities as the liabilities which arise from funding the EFSF are also apportioned to the countries bearing liability.

financial enterprise that performs a central counterparty function in financial transactions.

Credit institutions

Unsecuritised cross-border activities within the banking system likewise resulted in net capital outflows However, credit institutions reported net inflows of funds worth €113½ billion. On the one hand, this was due to the fact that German institutions continued to deleverage, thereby reducing their unsecuritised foreign exposure by a further €62 billion in 2012, mainly shrinking their portfolio of long-term financial loans. On the other hand, the heightened uncertainty in the euro area channelled large net inflows of funds from abroad to domestic banks (€51½ billion), especially at the beginning of the year.

Bundesbank

In 2012, the Bundesbank recorded net capital exports of €132½ billion. As in previous years, these ultimately stemmed from transactions executed via the TARGET2 payment system. The TARGET2 balance grew by €192½ billion in the reporting period. However, the increase occurred mainly in the first half of 2012 in the context of the escalating sovereign debt crisis, as already stated;[9] at the end of the year, the balance was tending to fall a little. By contrast, moves by non-residents to augment their balances with the Bundesbank led to capital inflows in the amount of €60 billion. Besides the credit balances of the ESM and the EFSF, this mainly related to temporary deposits parked at the Bundesbank by other central banks.

Reserve assets

Transactions …

Transaction-related changes in the reserve assets are shown as a separate item in the balance of payments. In 2012, these amounted to around €1½ billion on balance and were principally the result of a slight increase in foreign currency reserves.

… and balance sheet adjustments

As in past years, the international reserve holdings were also influenced by balance sheet adjustments which, in line with internationally agreed accounting standards, are not recognised in the balance of payments. The end-of-year revaluation of the reserve assets at market prices resulted in an increase of €2½ billion (2011: €19½ billion), due mainly to gains on gold. This result was, however, offset by an exchange rate-related decline in the foreign currency reserves as well as in the reserve position in the IMF. All in all, Germany's reserve assets rose by €4 billion in balance sheet terms to €188½ billion at the cut-off date of 31 December 2012.

9 For more information on this increase in the TARGET2 balance in the first half of 2012, see also Deutsche Bundesbank, Recent developments with regard to TARGET2 balances, Monthly Report, November 2012, p 49.