Financial markets

Financial market setting

Economic conditions and monetary policy stance the main drivers on the financial markets

Favourable economic conditions, US fiscal policy and monetary policy on both sides of the Atlantic shaped events on international financial markets in the fourth quarter of 2017 and at the beginning of the new year. Yields on sovereign bonds were initially mixed. One reason for this was the differing monetary policy stances in the euro area and the United States. For example, yields in the euro area initially came under pressure as the expectation on the market increasingly took hold that the ECB Governing Council would, at its meeting at the end of October 2017, decide to continue the asset purchase programme beyond 2017. At the same time, the US Federal Open Market Committee (FOMC) continued its gradual tightening of monetary policy and raised its key interest rate at its December meeting, in line with expectations. Consequently, the yield spread between ten-year US Treasuries and German Federal bonds (Bunds) with the same maturity widened perceptibly. Yields then rose sharply worldwide as of mid-December, with stimulus being provided, amongst other things, by the tax reform in the United States (Tax Cuts and Jobs Act), which was passed before the end of the year. Furthermore, it became clear that the economic upswing was maintaining its great momentum not only in the euro area and the United States, but around the world. Not least in light of market expectations of a less expansionary monetary policy stance in the two major currency areas and higher term premiums, the yields on ten-year US Treasuries and German Bunds rose significantly to 2.9% and 0.7% respectively. On the international stock markets, the aforementioned factors were reflected in higher profit expectations and a greater appetite for risk amongst investors, causing stock prices to rise – in some cases, considerably – and new interim highs to be reached in both Germany and the United States. At the beginning of February, however, rising yields prompted a noticeable stock market correction, forcing the European markets to surrender all their gains and end the period with net losses. On the foreign exchange markets, there were perceptible shifts in exchange rates to the detriment of the US dollar and to the benefit of the euro as of the fourth quarter of 2017.

Exchange rates

US dollar weak on the foreign exchange markets

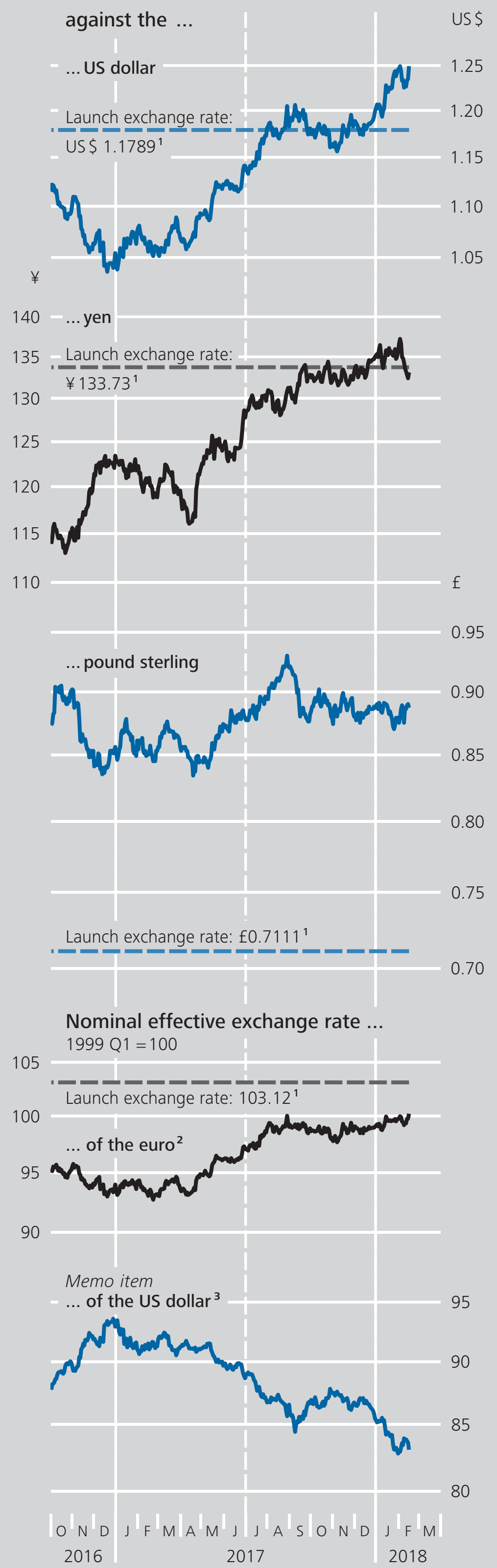
The foreign exchange markets were characterised, particularly in the new year, by a broad-based weakness of the US dollar and increased, but still comparatively low, implied exchange rate volatility. As of the end of October, the US dollar continued the downward slide it had begun in January 2017, albeit with intermittent interruptions. As a result, it lost 9.3% in value on a weighted average against 56 trading partners compared to the beginning of 2017. It recorded significant losses against European currencies, in particular, falling against the euro (-15.6%) and against the pound sterling (-12.6%), for instance, but also against the yen (-9.0%). By contrast, the euro appreciated on a weighted average over the reporting period as of September – driven mainly by gains against the US dollar – but was also up on its level at the beginning of 2017. This happened against the backdrop of surprisingly buoyant economic activity in the euro area.

Euro up markedly against the US dollar

The euro appreciated perceptibly against the US dollar during November following the publication of a series of surprisingly strong domestic economic data. Economic growth and consumer confidence in Germany, for example, as well as a purchasing managers' index for the euro area, were all unexpectedly favourable. In addition, the Ifo business climate index of the German economy rose unexpectedly to a new all-time high. At the end of the month, however, the euro surrendered some of its gains

Exchange rate of the euro

Daily data, log scale



Source: ECB. **1** Exchange rate at the start of monetary union on 4 January 1999. **2** As calculated by the ECB against the currencies of 19 countries. **3** As calculated by the Bundesbank against the currencies of 19 countries.

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against the US dollar, after the index for consumer sentiment in the US rose surprisingly strongly to reach its highest level in 17 years. The Senate's consent to the tax reform in the United States and the associated expectations of a fiscal stimulus subsequently gave the US dollar an additional boost.

However, following the mid-December monetary policy meeting of the Federal Reserve, the mood reversed again in favour of the single currency after the Fed, in line with expectations, decided to increase key interest rates and signalled that it would stick to the path of moderately raising interest rates. In light of the favourable growth prospects for the euro area, the euro subsequently started to appreciate once again. Its appreciation intensified in mid-January, after the account of the most recent meeting of the ECB Governing Council indicated that the latter might deliberate on an adjustment to monetary policy communication early this year. In addition, in the subsequent period, a looming budget freeze in the United States contributed to the depreciation of the US dollar. Furthermore, at times there was an impression on the markets that the US Administration supported the weakness of the US dollar. As this report went to press, the euro stood at US$1.25, which was up 5.8% on its level at the end of September 2017 and its highest level since December 2014.

By contrast, substantial gains against the yen only temporary

Supported by the above-mentioned favourable economic outlook for the euro area, on the one hand, and the prospect of a continued expansionary monetary policy of the Bank of Japan, on the other, the euro also appreciated against the yen as of the third week of November 2017. After the announcement of Japan's central bank that it had purchased fewer particularly long-dated government bonds, the euro temporarily lost some of the ground it had previously gained against the yen. However, at the start of February it reached its highest level since August 2015, trading at ¥137. In the wake of the marked correction on the global equity markets in the first week of February and the ensuing rise in uncertainty on the financial markets, the yen appreciated on a broad basis. As this report went to press, the euro was trading at ¥133, which was 0.2% above its value at the start of the reporting period.

Slight appreciation against the pound sterling

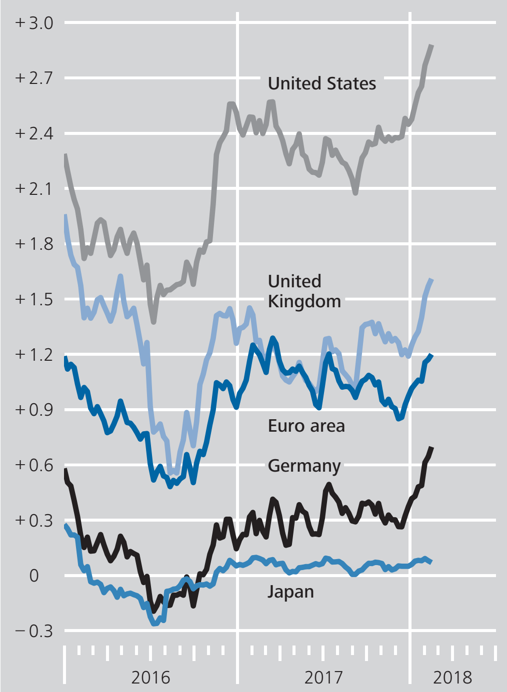
Despite notable variability, the euro traded against the pound sterling during the reporting period without any clearly discernible trend. Fluctuations of the euro-pound sterling rate were influenced primarily by the developments surrounding the planned withdrawal of the United Kingdom from the European Union (EU). After London and Brussels agreed, in principle, at the end of November on the financial consequences of a withdrawal, the euro came under downward pressure against the pound sterling. Subsequently, however, the uncertainty over the outcome of the EU exit negotiations increased once more and the euro made good on a large part of the previous losses. In mid-January, the pound sterling appreciated significantly on a broad basis after the publication of unexpectedly favourable data on the British labour market and mounting signs that economic growth in the UK had been higher than expected in the fourth quarter of 2017. As this report went to press, the euro stood at £0.89, up 0.5% on its level at the end of September.

Euro appreciated in effective terms

Measured against the currencies of 19 major trading partners, the euro appreciated by 1.3% compared to the end of September. The marked gains, particularly against the US dollar, contrasted with losses against some central European currencies, for example, such as the Polish zloty (-3.5%) and the Czech koruna (-2.4%). The price competitiveness of euro area suppliers deteriorated somewhat as a result of the euro's appreciation, but in the context of the long-term average their competitive position can currently continue to be regarded as neutral.

Yields* in the euro area and selected countries

% pa, weekly averages



Source: Thomson Reuters. * Government bonds with a residual maturity of ten years.
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Securities markets and portfolio transactions

Economic activity and monetary policy push yields higher globally …

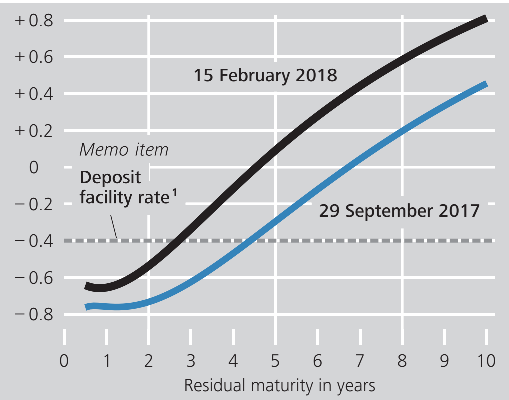
Yields on government bonds have risen sharply around the world on balance since the end of September 2017. This is mainly due to the fact that the recovery has become more broadly based around the globe. The cyclical improvement contributed to the expectation among market participants that key central banks would raise rates earlier than previously anticipated. Furthermore, term premiums, which compensate for the willingness to accept securities for a longer period, have also increased sharply since mid-December.

… and also in the euro area

However, yields in the euro area fell initially and continued to do so well into December. This was partly due to the decision of the ECB Governing Council in October to continue the asset purchase programme and to purchase €30 billion worth of securities per month as of January

Yield curve on the German bond market*

%



* Interest rates for (hypothetical) zero-coupon bonds (Svensson method), based on listed Federal securities. 1 Current interest rate on the deposit facility in place since 15 March 2016.
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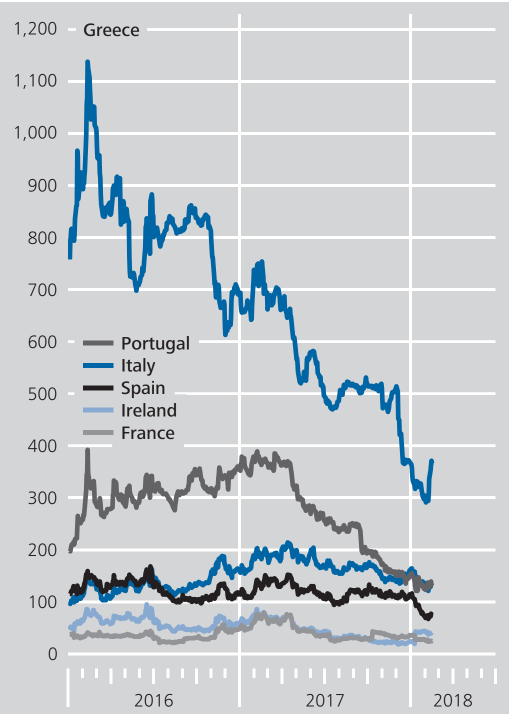
Spreads of ten-year government bonds over German Federal bonds

Basis points, daily data



Sources: Thomson Reuters and Bundesbank calculations.
Deutsche Bundesbank

2018 until at least the end of September 2018. Although the decision itself did not have any discernible impact on the markets, prior to the meeting the clear signals from the ECB that it would further loosen monetary policy did temporarily place yields under pressure. At the end of the year, however – after a number of indicators exceeded expectations – the focus shifted back to the positive economic trend. The account of the ECB Governing Council's monetary policy meeting in December, which was published on 11 January 2018, partly contributed to this. Some market participants saw this as a surprisingly positive economic assessment by the ECB Governing Council. As a result, they assumed that the Eurosystem could potentially normalise monetary policy somewhat faster than previously expected. On balance, the GDP-weighted yield on ten-year government bonds in the euro area rose to 1.2%, up 15 basis points since the end of September.

Continuing rise in Bund yields …

Yields on Federal bonds (Bunds) rose even more sharply, up 35 basis points to 0.7%. This is the highest level reached since 2015, when, during the so-called "Bund tantrum", interest rates rose in several stages to nearly 1.0% for a while. However, unlike then, this time the rise in interest rates was attributable to the fundamentally improved economic outlook.

… causing the entire yield curve to steepen

As a result of the aforementioned factors, the yield curve derived from yields on Federal securities shifted upwards and steepened slightly. The spread between ten-year and two-year bonds stood at 135 basis points as this report went to press and was thus 16 basis points higher than at the end of September. Yields with a residual maturity of five years are in positive territory again for the first time since September 2015. The scarcity premiums on Federal securities, as measured, for example, by the yield spread between EONIA swaps and bonds of an equivalent maturity, declined over the reporting period, particularly in the short-term segment.

Decline in risk premiums for euro area government bonds

Yield spreads between ten-year Bunds and government bonds of the other euro area countries fell during the reporting period by 21 basis points to 65 basis points (in the GDP-weighted average). They therefore reached their lowest level since the beginning of 2010. Yields on the bonds of individual euro area countries put in a mixed performance. While yields on government bonds of the highest credit quality, in particular, rose considerably, yields fell in some countries with weaker credit ratings. This was partly due to the generally good economic situation, which reduced the risk of default on the whole. Furthermore, country-specific factors also played a role. For example, Portuguese and Spanish government bonds benefited from rating upgrades by one rating agency.

Year-end effects on repo market short-lived

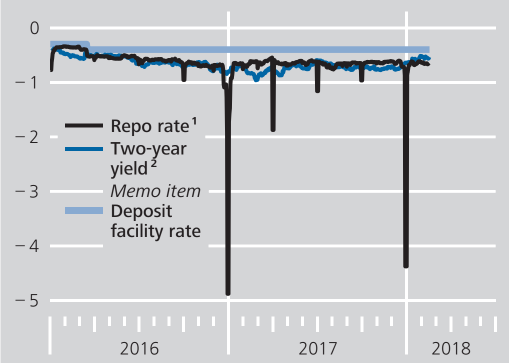
Year-end effects were once again observed on the market for overnight credit secured by European government bonds (repo market). On and around the balance sheet date, the (negative) money market rate (repo rate) and the volume of secured overnight credit decreased significantly. Some providers of collateral clearly refrained from extending such loans beyond the end of the year. Regulatory reasons are likely to be one of the main motivations for this, as scaling back repo transactions leads to a smaller balance sheet on the part of the provider of the collateral. These year-end effects were, however, of a very temporary nature and did not have a lasting impact on the repo market itself or on the government bond markets. Ultimately, the Eurosystem's securities lending facilities are likely to also have contributed to this.

Recovery of market-based inflation expectations in the euro area continues

Market-based inflation expectations for the next few years in the euro area continued the moderate upward trend begun in the second quarter of 2017 across all horizons. The five-year forward inflation rates in five years derived from inflation swaps rose to 1.8%, which was 12 basis points higher than at the end of September 2017. The average inflation expectations for the euro area six to ten years ahead, as computed by Consensus Economics on the basis of surveys, remained stable at 1.9%. When interpreting this discrepancy, it is necessary to bear in mind the possible liquidity and inflation risk premiums that influence market-based measures and reduce their informative value in economic terms. However, as this report went to press, market-based and survey-based measures of inflation expectations were converging again as a result of rising term premiums. The probability of deflation over the next five years based on options data declined further, sinking to a new multi-year low of below 5% for a while.

Repo rate and yield on short-dated Federal securities

% pa, daily data



1 Money market rate for overnight credit secured by German government bonds. Source: repofundsrate.com. **2** Yield on a two-year zero-coupon bond from the German yield curve.

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European corporate bond yields virtually unchanged

European enterprises' financing conditions remain favourable. Yields on BBB-rated European corporate bonds with a maturity of seven to ten years rose by 10 basis points on balance compared to the end of September. Whereas the yields on bonds issued by financial corporations remained virtually unchanged, bonds issued by non-financial corporations recorded an increase of 13 basis points, delivering a yield of 1.6% as this report went to press. Given the increase in government bond yields, yield spreads in the corporate sector over safe Federal bonds fell by 31 and 19 basis points respectively for financial and non-financial corporations. The yield spreads in both corporate sectors were therefore at levels not seen since before the onset of the financial crisis in July 2007. This development is probably partially attributable to the continued highly accommodative monetary policy for the euro area, of which the corporate sector purchase programme is a part. Furthermore, the positive economic situation is contributing to a reduction in default risk.

Forward inflation rates and expectations in the euro area

Sources: Thomson Reuters, Consensus Economics and Bundesbank calculations. **1** Derived from the fixed cash flow arising from inflation swaps which is swapped for the actual annual inflation rates (HICP excluding tobacco) realised over the next five or ten years. Weekly averages.
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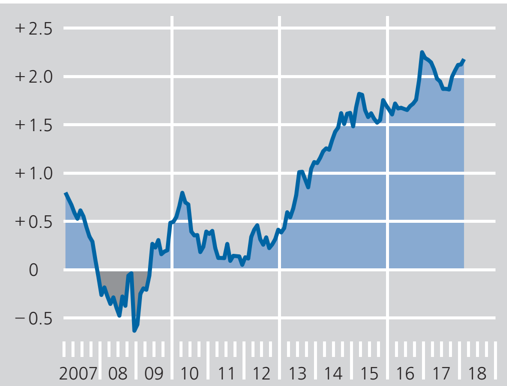
Yield spread between US and German government bonds*

Percentage points, monthly data



1 Source: Thomson Reuters. * US Treasury yields less Bunds, each with a residual maturity of ten years.
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Strong rise in yields in the United States

Among the global benchmark bonds, yields on ten-year US Treasuries rose the sharpest over the reporting period (up 58 basis points). This was due primarily to strong domestic activity in the United States, which was reflected in continued positive US labour market figures, and to the higher than expected path of inflation. In addition, the US tax reform, which Congress adopted before the turn of the year and which is likely to put supply-side pressure on the US bond market, further boosted yields. While the Fed's 25-basis-point increase in the policy rate in December had been largely anticipated, the expected path for short-term interest rates in the United States has become steeper overall. On balance, the interest rate differential between the United States and the euro area widened further. The yield spread between ten-year US Treasuries and German Bunds with the same maturity stood at 217 basis points as this report went to press, placing it in the upper 2% quantile of a long-term comparison since 1999.

Yields in Japan and the United Kingdom

As a result of the interest rate linkage between the major currency areas, interest rates in the United Kingdom also increased substantially. As this report went to press, ten-year gilts yielded 1.7%, up 28 basis points compared to the end of September. In Japan, by contrast, the bond market remains virtually sealed off from international developments. Here, the Bank of Japan's yield curve control ensured that yields on ten-year government bonds remained within a narrow corridor of between two and eight basis points.

Net redemptions of domestic debt securities

Gross issuance on the German bond market in the fourth quarter of 2017 was down slightly on the previous quarter. Overall, German borrowers issued paper worth €240½ billion, compared with €257½ billion in the previous three months. Net of redemptions and changes in issuers' own holdings, domestic issuers scaled back their capital market borrowing by €7 billion. The outstanding volume of foreign debt securities in the German market rose by €3 billion in the fourth quarter. On balance, the total outstanding volume of bonds in Germany thus shrank by €4 billion in the quarter under review.

Fall in credit institutions' capital market debt

From October to December, domestic credit institutions reduced their capital market debt compared to the previous quarter by €14½ billion. Net redemptions centred on debt securities issued by specialised credit institutions and other bank debt securities which can be structured flexibly (€10 billion and €6 billion respectively). By contrast, the outstanding volume of mortgage Pfandbriefe and public Pfandbriefe rose slightly (€½ billion in each case).

Net public sector issuance

The public sector issued debt instruments totalling €5 billion net in the quarter under review. Central government (and the resolution agency classified as part of central government) was the main issuer of ten-year and 30-year bonds, which were issued in the amount of €12 billion and €2½ billion respectively. This contrasted with net redemptions of five-year Federal notes (Bobls) totalling €10 billion and Federal Treasury discount paper (Bubills) worth €1½ billion. State and local governments issued debt securities with a net value of €1½ billion.

Net issuance of corporate bonds

In the fourth quarter of 2017, domestic enterprises issued bonds worth €2½ billion net. On balance, this was exclusively long-term paper.

Purchases of debt securities

The Bundesbank was by far the largest net purchaser of debt securities in the fourth quarter of 2017. Mainly under the Eurosystem's asset purchase programmes, it acquired debt securities worth €35½ billion net, principally in the form of German government bonds. Domestic non-banks bought bonds worth €16½ billion net, the bulk of which were domestic securities. By contrast, foreign investors and domestic credit institutions disposed of fixed-income securities worth €42½ billion and €13½ billion respectively.

Investment activity in the German securities markets

€ billion

Item	2016 Q4	2017 Q3	2017 Q4
Debt securities			
Residents	17.9	18.8	38.7
Credit institutions	– 19.6	– 23.6	– 13.5
of which			
Foreign debt securities	– 5.2	– 5.5	– 0.3
Deutsche Bundesbank	49.5	34.3	35.6
Other sectors	– 12.1	8.0	16.6
of which			
Domestic debt securities	– 1.5	– 15.1	11.7
Non-residents	– 57.6	– 26.4	– 42.7
Shares			
Residents	2.3	12.8	19.3
Credit institutions	1.8	– 3.0	4.8
of which			
Domestic shares	1.6	– 0.8	2.9
Non-banks	0.5	15.8	14.5
of which			
Domestic shares	– 6.4	5.2	– 1.7
Non-residents	6.6	– 2.3	0.0
Mutual fund shares			
Investment in specialised funds	33.8	10.5	24.1
Investment in open-end funds	6.0	8.9	5.2
of which			
Equity funds	3.4	3.6	0.8

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Equity market

Strong gains seen for a while fully eroded in some cases by end of reporting period

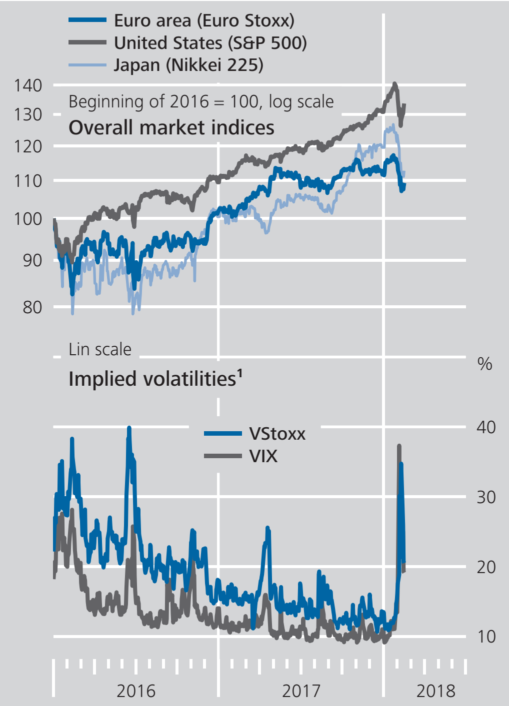
Buoyed by the positive economic environment, the international equity markets initially recorded significant gains in the reporting period, which was reflected in a high valuation level. There were marked corrections at the beginning of February as a result of perceptions among some market participants that the Fed would, owing to the good economic data, raise interest rates faster than had previously been anticipated. Rising risk-free interest rates reduce the discount factor, which is used to value future profits, and thus lower the present value of public limited companies. Nevertheless, on balance, the US S&P 500 rose by a total of 8.4% compared to the end of September last year, and for a time attained a new all-time high. This was due not only to the good state of the US economy, but also to the US tax reform adopted in December, which includes a significant reduction in enterprises' tax burden. In addition, analysts upped their projection of earnings per share 12 months ahead as well as their assessments of medium-term earnings growth. The December interest rate hike and the expectation among market participants that the Fed would continue to tighten monetary policy this year only started to exert a dampening impact on equity prices in the United States at the beginning of February.

US bank equities up significantly

Bank equities in the United States climbed by 16.2%, significantly outperforming the US market as a whole. This increase was accompanied by a strikingly sharp rise in earnings expectations for the next 12 months, which were up by 18.4%. Medium-term earnings expectations rose, too. Like enterprises in the real economy, banks will also benefit in the medium term

Equity market

Daily data



Sources: Thomson Reuters and Bundesbank calculations. **1** Calculated using the prices of index options. For euro area, calculated from options on Euro Stoxx 50.

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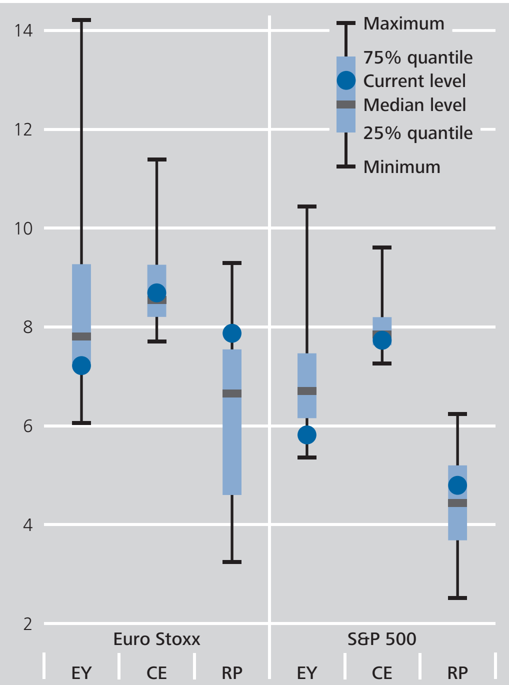
Stock market valuations

Data since January 2004



Sources: Thomson Reuters I/B/E/S, Bundesbank calculations. Earnings yields (EY) as an inverted price/earnings ratio; implied cost of equity (CE) and equity risk premium (RP) derived from the dividend discount model.

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from the lower US taxes on earnings. That said, individual institutions recorded significant extraordinary expenses for 2016 as a result of the tax reform. Overall, therefore, despite the strong rise in equity prices, the price-earnings ratio of US banks remained virtually unchanged.

European equities lower at end of reporting period

The interim price gains in the European equity markets were significantly weaker than those in the US market, probably mainly due to the strong appreciation of the euro against the US dollar. Following the global correction, the broad Euro Stoxx index ended the period under review 3.0% lower than it was at the start. The CDAX also recorded net losses (-2.3%), having previously climbed – like the S&P 500 – to a new all-time high. However, during the reporting period, the European automobile sector, in particular, significantly outperformed the market as a whole (6.8%). Here again, the US tax reform is likely to have been one of the reasons for this development, causing (future) tax burdens recognised in the balance sheet to fall significantly in some cases for European car manufacturers that produce in the United States. By contrast, bank shares in the euro area recorded declines of 3.9% and were thus largely in line with the overall index. Prices were supported, amongst other things, by the Basel III reform package adopted in December 2017, which aims to strengthen financial stability and contribute to harmonised regulation for the banking sector.

Japanese stock market sees rise

Given the good economic outlook and a monetary policy stance that remains highly accommodative, the Japanese equity market also initially continued the upward trend it had embarked upon in September 2017. The Nikkei 225 climbed to its highest level since 1991 – and even following the recent significant falls was still 5.4% higher, at last count, than at the end of September 2017. Despite the continuing uncertainty regarding the future links to the EU, the British equity market proved to be comparatively robust. The broad FTSE All-Share Index lost somewhat less than the Euro Stoxx on balance (-1.8%).

Significantly higher price uncertainty in the stock market

Market participants' uncertainty about future stock price developments – as measured by the implied volatility of equity indices calculated on the basis of options – increased significantly of late in light of the correction on the equity markets at the beginning of February. It was above its five-year average for both the Euro Stoxx and for the US equity market.

Stock market funding at low level

On balance, funding on the German stock market totalled €1 billion in the reporting quarter. The volume of foreign shares on the German market rose by €18 billion in the same period. Equities were purchased predominantly by domestic non-banks and credit institutions (to the tune of €14½ billion and €5 billion respectively). While credit institutions acquired more domestic paper, non-banks focused their interest on foreign shares. On balance, non-resident investors reduced their portfolio of German shares only marginally.

Significant rise in sales and purchases of mutual fund shares

In the final quarter of 2017, domestic investment companies recorded a net inflow of €29½ billion, compared with €19½ billion in the previous quarter. On balance, the vast majority of the fresh funds were channelled to specialised funds reserved for institutional investors (€24 billion). Of the various asset classes, mixed securities funds, in particular, registered significant net inflows of capital (€10½ billion), as did, albeit to a lesser extent, open-end real estate funds (€6 billion), equity funds (€5½ billion) and funds of funds (€5 billion). The outstanding volume of foreign mutual fund shares in Germany rose by €14½ billion in the period under review. On balance, investment fund shares were bought exclusively by domestic non-banks, which added paper worth €47 billion to their portfolios in net terms. Most of this paper was issued by domestic mutual funds. This contrasted with net sales by non-resident investors and domestic credit institutions to the tune of €3 billion and €½ billion respectively.

Major items of the balance of payments

€ billion

Item	2016 Q4	2017 Q3	2017 Q4p
I Current account	+ 68.2	+ 62.6	+ 73.9
1 Goods[1]	+ 60.8	+ 68.0	+ 64.6
2 Services[2]	− 2.2	− 11.1	+ 0.4
3 Primary income	+ 21.1	+ 16.6	+ 23.5
4 Secondary income	− 11.6	− 11.0	− 14.5
II Capital account	+ 0.1	+ 0.9	− 1.3
III Financial account (increase: +)	+ 82.5	+ 54.0	+ 74.1
1 Direct investment	+ 28.9	+ 0.5	+ 14.5
Domestic investment abroad	+ 21.4	+ 21.5	+ 27.8
Foreign investment in the reporting country	− 7.5	+ 21.0	+ 13.3
2 Portfolio investment	+ 51.0	+ 58.9	+ 69.9
Domestic investment in foreign securities	− 0.6	+ 30.8	+ 23.5
Shares[3]	+ 3.4	+ 5.1	+ 5.8
Investment fund shares[4]	+ 9.9	+ 10.6	+ 14.7
of which Money market fund shares	+ 2.6	+ 0.1	+ 1.8
Long-term debt securities[5]	− 9.7	+ 16.5	+ 7.7
of which Denominated in euro[6]	− 7.7	+ 6.9	+ 4.3
Short-term debt securities[7]	− 4.2	− 1.4	− 4.7
Foreign investment in domestic securities	− 51.6	− 28.0	− 46.4
Shares[3]	+ 6.4	− 2.3	− 0.8
Investment fund shares	− 0.4	+ 0.6	− 2.9
Long-term debt securities[5]	− 29.3	− 21.0	− 40.3
of which Issued by the public sector[8]	− 43.1	− 18.8	− 22.5
Short-term debt securities[7]	− 28.3	− 5.4	− 2.4
3 Financial derivatives[9]	+ 13.5	+ 1.4	+ 4.0
4 Other investment[10]	− 10.9	− 6.9	− 12.9
Monetary financial institutions[11]	+ 22.3	− 12.5	+ 16.8
Enterprises and households[12]	− 27.4	− 3.7	− 17.8
General government	− 1.8	− 8.5	+ 11.4
Bundesbank	− 4.0	+ 17.7	− 23.3
5 Reserve assets	0.0	+ 0.2	− 1.4
IV Errors and omissions[13]	+ 14.3	− 9.5	+ 1.5

1 Excluding freight and insurance costs of foreign trade. 2 Including freight and insurance costs of foreign trade. 3 Including participation certificates. 4 Including reinvested earnings. 5 Long-term: original maturity of more than one year or unlimited. 6 Including outstanding foreign D-Mark bonds. 7 Short-term: original maturity up to one year. 8 Including bonds issued by the former Federal Railways, the former Federal Post Office and the former Treuhand agency. 9 Balance of transactions arising from options and financial futures contracts as well as employee stock options. 10 Includes in particular financial and trade credits as well as currency and deposits. 11 Excluding the Bundesbank. 12 Includes the following sectors: financial corporations (excluding monetary financial institutions) as well as non-financial corporations, households and non-profit institutions serving households. 13 Statistical errors and omissions, resulting from the difference between the balance on the financial account and the balances on the current account and the capital account.

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Direct investment

Net capital exports in direct investment

As with cross-border portfolio investment, which saw net outflows to the tune of €70 billion in the fourth quarter of 2017, net capital exports were likewise recorded in the field of direct investment; these amounted to €14½ billion.

Domestic enterprises invested abroad …

Direct investment abroad by German enterprises came to €28 billion net in the final quarter of 2017. Domestic investors boosted their equity capital by €23 billion, thus also reinvesting profits abroad (€4 billion). In addition, they issued intra-group loans in the amount of €4½ billion. €7½ billion was accounted for by the granting of additional trade credits, while financial loans were curtailed (€2½ billion). Countries receiving substantial direct investments from Germany included Luxembourg (€19½ billion) and France (€6½ billion) within the euro area, and China (€3½ billion) outside it. By contrast, domestic enterprises disinvested in Belgium to the tune of €9 billion. The outflows of funds took place, amongst other things, as a result of a corporate restructuring, which was also partly the reason for the aforementioned capital exports to Luxembourg.

… and foreign enterprises carried out foreign direct investment in Germany

Foreign investors also increased their direct investment in Germany from October to December 2017 by €13½ billion. On the one hand, they provided additional equity capital to branches in Germany (€10½ billion). On the other hand, they increased their lending to affiliated enterprises in Germany (€2½ billion), particularly though trade credits. In regional terms, investors from the EU, especially from Sweden (€5 billion), France (€4½ billion) and Denmark (€4 billion), played the largest role. By contrast, there were significant outflows to Luxembourg (€8½ billion) and the United Kingdom (€3½ billion) – in both cases primarily in the form of intra-group credit transactions, and, in the case of Luxembourg, predominantly through the repayment of loans that had previously been granted by foreign branches to their parent companies in Germany (reverse flows).