Financial markets

Financial market setting

Falling yields affect financial markets

Developments on the international financial markets in recent months have been shaped by geopolitical tensions and adjusted expectations for global growth. For example, the International Monetary Fund has lowered its growth forecast for the global economy this year and next. The euro area and, for a while, Japan were among the harbingers of negative economic data, while the United States' economic situation and prospects are by and large expected to be more favourable. This was also reflected in differing monetary policy measures. The ECB Governing Council adopted further expansionary monetary policy measures in September. The same is true of the Bank of Japan, which announced in October that it would further accelerate the expansion of the monetary base. By contrast, the US Federal Reserve phased out its bond purchase programme (quantitative easing) at the end of October, as most market participants had expected. As a result, benchmark bond yields fell considerably on the major bond markets from the end of June onwards. By contrast, the international stock markets showed divergent developments amid temporarily heightened volatility, with European equities in particular recording losses. On the foreign exchange markets, exchange rate parities moved in favour of the US dollar. The euro, by contrast, forfeited approximately 3½% of its trade-weighted value compared with the end of June.

Exchange rates

Euro declines markedly against the US dollar on balance, …

On the foreign exchange markets, market participants' interest was focused on the euro-dollar exchange rate. Diverging assessments of the economic situation for the euro area and the United States as well as further monetary policy easing by the Eurosystem had a markedly negative impact on the euro exchange rate. This effect was heightened by expectations of a possible earlier interest rate reversal in the United States, which led to a positive market sentiment in favour of the US dollar. Compared with the end of June, the euro depreciated against the US dollar by around 9% on balance, continuing the downward trend that began in spring. For a time, the value of the euro fell to below US$1.24, its lowest level since August 2012.

… and falls temporarily to its lowest level since August 2012

Euro burdened by monetary policy easing and concerns about the euro-area economy …

The euro exchange rate was weakened, in particular, by the ECB Governing Council's unexpected rate cut to a new all-time low of 0.05% in September, the announcement of purchase programmes for asset-backed securities and covered bonds, and by speculation about further measures possibly being taken to ease monetary policy in the euro area given the low inflation rate and disappointing economic data. Speculation among market participants about further monetary policy easing measures was stoked additionally by ECB President Mario Draghi's statement to the effect that he would use further unconventional measures, if need be, to address the risks of an excessively long period of low inflation.

… and market participants' growing expectations of an earlier interest rate reversal in the United States

By contrast, the Fed further continued to taper the purchase amounts under its bond purchase programme through the summer, too, and decided at the end of October to halt the programme altogether. Most market participants had expected this move; however, given the better-than-expected cyclical indicators and the Fed's upbeat assessment of the economic situation, the probability also grew in the eyes of market participants of an earlier interest rate reversal in the United States. This benefited the US dollar and intensified the downward pressure on the single European currency. The euro latterly stood at just under US$1.25, close to its hitherto lowest point this year.

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 20 countries.
Deutsche Bundesbank

Single currency gains against the yen, …

On balance, the euro appreciated against the yen from mid-year onwards. After initially losing in value following the monetary policy easing in the euro area, the single currency strengthened markedly against the Japanese currency following the Bank of Japan's unexpected announcement at the end of October that it would accelerate its annual expansion of the monetary base to further ease its monetary policy stance. As this report went to press, the euro was trading at ¥144, which was around 4% up on its end-June level.

… loses some ground against the pound sterling …

Conversely, the single currency lost some ground against the pound sterling. Here, too, the reasons described above had a negative impact on the euro exchange rate. In addition, the euro weakened against the pound sterling following the Bank of England's hints of a possible interest rate increase at the beginning of 2015. The euro recovered somewhat for a time when it appeared possible that a majority would vote for Scottish independence in the referendum – the majority eventually did not materialise, however. At the end of the reporting period, the euro was trading at £0.79, or around 1½% lower than at the end of the second quarter.

… and makes strong gains against the rouble

The euro posted marked gains against the rouble although the Russian central bank raised its policy rates substantially and intervened in the foreign exchange market. Compared with the end of June, the euro appreciated by approximately 25%. The rouble was adversely affected by the geopolitical situation in east Ukraine, the sanctions imposed on Russia, a decline in investor confidence and a significant drop in fossil fuel prices. In mid-November, the Russian central bank announced that it would abandon the prevailing exchange rate band, at the edges of which it intervened to stabilise the exchange rate. However, it continues to reserve the right to intervene in the interest of financial stability.

Effective exchange rate of the euro weaker

Vis-à-vis the currencies of the euro area's 20 most important trading partners, the euro sustained a loss in value of 3½% compared with the end of June. Most recently, the single currency was thus trading 3½% below its level at the launch of monetary union. In real terms, too – ie taking account of the inflation differentials between the euro area and its major trading partners – the effective euro exchange rate fell somewhat in the period under review. The price competitiveness of euro-area exporters has improved accordingly as a result: allowing for estimation uncertainty, it is to be deemed more or less neutral.

Securities markets and portfolio transactions

United States also experiences falling interest rates

On the bond markets, the combination of uncertainty about the future development of the world economy and the constantly recurring bouts of geopolitical tension led to temporary safe haven flows into US Treasuries. As a result, yields on ten-year US Treasuries dropped 20 basis points to a level of 2.4% from the end of June. The widely anticipated end of the Fed's programme of purchasing Treasuries and mortgage-backed securities had no marked impact on yields. The Bank of Japan's decision at the end of October to further accelerate the expansion of the monetary base had the effect of driving down yields on Japanese government bonds.

Geopolitical risks and cyclical downturn set the tone on the European bond market

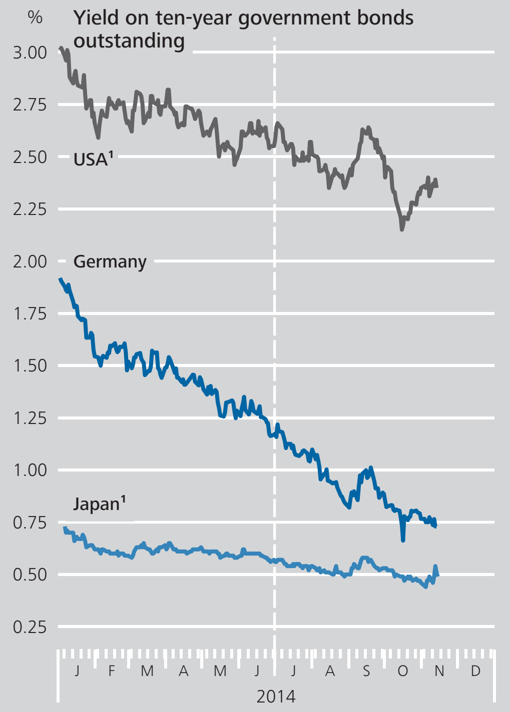
Against the backdrop of reduced growth expectations and surprisingly low inflation rates, financial investors' demand for government bonds remained strong in the euro area, too, and put downward pressure on yields. Moreover, the Eurosystem lowered its key interest rates at the beginning of September and announced purchase programmes for asset-backed securities and covered bonds. As a result, the GDP-weighted yield on ten-year bonds issued by euro-area countries (excluding Germany) contracted by 45 basis points, from 2.3% at the end of June to 1.8%; for a time, yields on most European government bonds had fallen yet again to new record lows. As this report went to press, ten-year Bunds were yielding 0.7%, or 44 basis points less than at the end of June, after their yields had even shrunk briefly to 0.66% in mid-October.

Yield movements mixed in the euro area

Within the euro area, yields on Greek government bonds saw an exceptional development. Discussions about an early exit from the international assistance programmes and about new parliamentary elections in Greece put considerable upward pressure on yields on Greek government bonds in the first half of October. Yields on ten-year bonds climbed more than 250 basis points in just a few days, but relinquished some of these gains in the days that followed. Nonetheless, yields latterly stood at 8.2%, or 219 basis points higher than at end-June. Developments in Greece had only a very weak impact on the other euro-area periphery countries. Compared with the end of June, yield spreads of most long-term government bonds issued by euro-area periphery countries narrowed against Federal securities with the same maturities.

Bond yields in Germany, Japan and the USA

Daily data



1 Source: Thomson Reuters.
Deutsche Bundesbank

Yield curve for German Federal securities flattens once again

Since the end of June, the slope of the German yield curve derived from the yields on Federal securities became flatter once again, slipping by 40 basis points to 91 basis points as measured by the yield differential between ten-year and two-year bonds. The tightening of the interest rate differential thus continued into the current reporting period (see the upper chart on page 50), which is an indication of expectations that the short-run interest rate will remain low for some time to come.

Yield curve on the German bond market*

%

* Interest rates for (hypothetical) zero-coupon bonds (Svensson method), based on listed Federal securities. 1 Day before the most recent interest rate cut by the ECB Governing Council.

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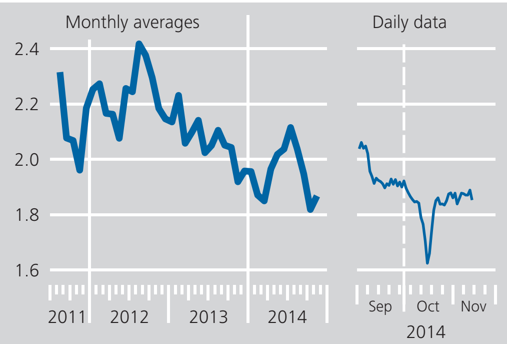
Five-year forward inflation rate in five years*

% pa



Sources: Euro MTS and Bundesbank calculations. * Derived from separately estimated yield curves of German and French inflation-linked and maturity-matched nominal bonds which are subsequently aggregated using GDP weights.

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Inflation expectations down

In view of the lacklustre economic recovery and the current low level of euro-area inflation rates, market-based longer-term inflation expectations have declined. The five-year forward inflation rate in five years based on French and German bonds dropped from 2.0% at mid-year to 1.9% (see the chart above). A sharp temporary decline in forward inflation rates in mid-October was triggered by a considerable drop in yields on nominal government bonds on the back of safe haven flows. However, this proved to be a short-lived phenomenon.

Further improvement in financing conditions for enterprises

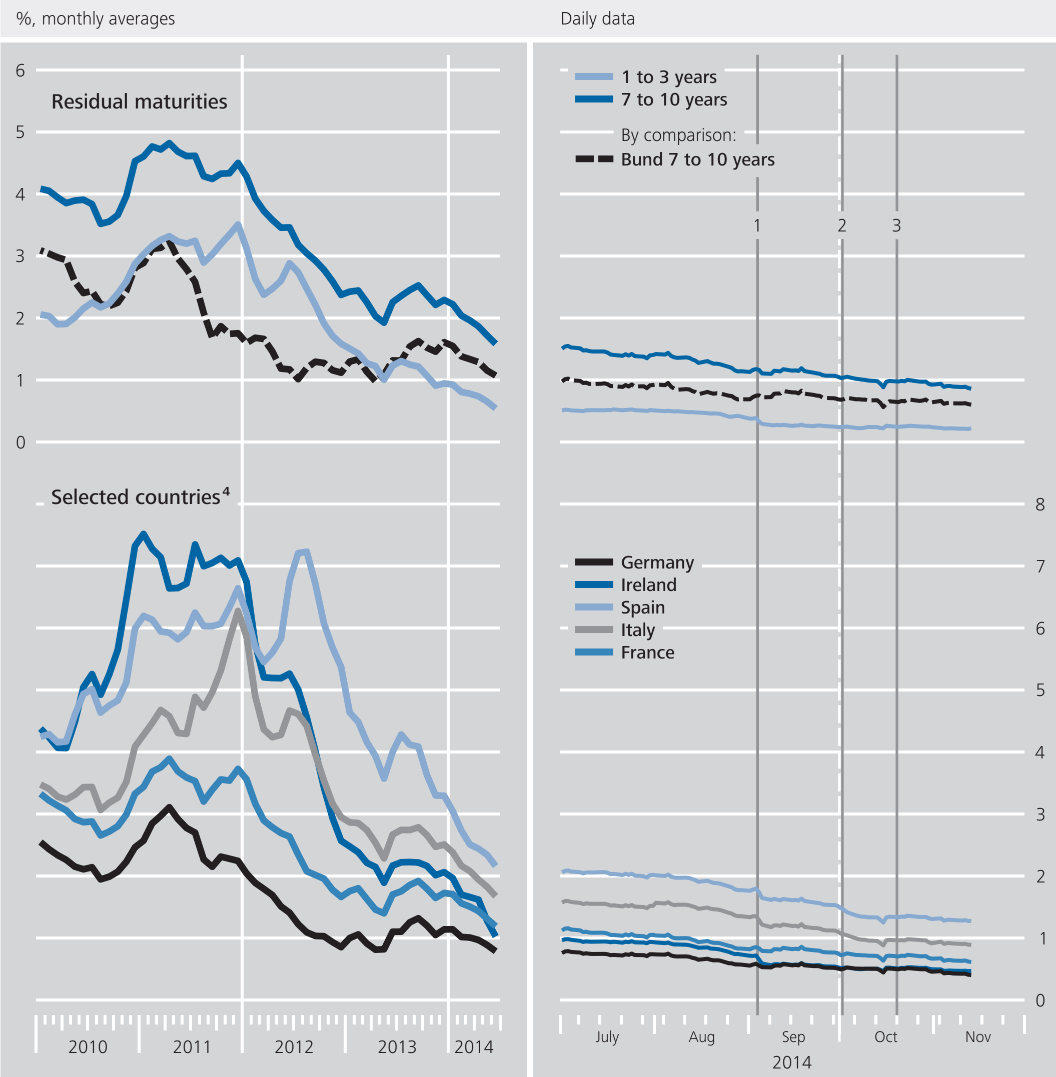
The already very favourable financing conditions for European enterprises in the capital market improved yet again. Yields on bonds issued by European non-financial corporations with a residual maturity of seven to ten years and with a BBB rating fell 39 basis points compared with the end of June to a level of 1.8%; meanwhile, yields on corresponding bonds issued by the financial sector likewise declined by 39 basis points to reach 3.0%.[1] Despite the falling Bund yields, spreads against German Federal bonds with the same maturity narrowed slightly. As a result, the lows of the previous quarter with regard to the absolute financing costs for European enterprises in the capital market were undercut once again. As before, investors' search for yield in the low-interest-rate environment is likely to have been the decisive factor here.[2]

Decrease in yields on covered bonds

As with corporate bonds, there was also a sharp decrease in yields on covered bonds, notably for longer maturities (see the chart on page 51).[3] Yields on covered bonds with a residual maturity of seven to ten years fell by 62 basis points from end-June to around 0.9% of late.[4] The yield spread over Bunds with the same maturities amounted to 26 basis points; declining by 25 basis points, it was more than halved in the period in question. The announcement, made after the ECB Governing Council's meeting in early September, of the purchase of covered bonds by the Eurosystem appears to have put downward pressure on yields. Compared with the previous day, yields on covered bonds dropped by some 10 basis points after the purchase programme was announced, although the effect of the announcement seems

1 These calculations are based on corporate bond yields included in the various iBoxx bond indices for different rating grades.
2 In its latest Global Financial Stability Report, the International Monetary Fund discusses the extent to which the valuation level in the corporate bond markets still adequately reflects default and liquidity risks. See International Monetary Fund, Global Financial Stability Report, October 2014, pp 1ff.
3 As measured using the iBoxx covered bond overall index for the euro area, which also contains German Pfandbriefe.
4 A strong decline was already recorded in the first half of 2014. At the beginning of the year, yields on covered bonds with the above-mentioned maturities stood at 2.4%.

Yields on covered bonds



Source: iBoxx. **1** ECB Governing Council meeting on 4 September 2014. **2** ECB Governing Council meeting on 2 October 2014. **3** Launch of CBPP3 on 20 October 2014. **4** All residual maturities.
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to be diminishing in the case of longer maturities. Moreover, the effect appears to be more pronounced in the case of covered bonds from periphery countries than of German or French paper.

Net bond market issuance

Gross issuance in the German bond market stood at €331½ billion in the third quarter of 2014 and was therefore below its previous-quarter level (€358½ billion). After deducting redemptions and taking account of changes in issuers' holdings of their own bonds, net issuance amounted to €4½ billion. In addition, foreign borrowers placed debt securities worth €14 billion on the German market. Thus, funds totalling a net €18 billion were raised in the German bond market in the reporting period.

Public sector borrowing moderate

The public sector raised €2½ billion in the bond market in the third quarter, compared with €14½ billion one quarter earlier. These figures include issues from resolution agencies of German banks, which are ascribed to the public sector for statistical purposes. Central government itself issued mainly five-year Federal notes (€10½ billion). At the same time, it redeemed ten-year Federal bonds (Bunds) and two-year Federal Treasury notes (Schätze) totalling €12½ billion and €2½ billion net respectively. In the quarter under review, state governments issued

Investment activity in the German securities markets

€ billion

Item	2013 Q3	2014 Q2	2014 Q3
Debt securities			
Residents	− 12.4	16.6	16.5
Credit institutions	− 7.7	1.2	4.9
of which			
Foreign debt securities	− 0.1	2.3	3.4
Deutsche Bundesbank	− 2.7	− 4.4	− 3.7
Other sectors	− 1.9	19.8	15.3
of which			
Domestic debt securities	− 21.4	− 9.8	1.7
Non-residents	− 10.9	10.3	1.7
Shares			
Residents	6.5	15.7	1.0
Credit institutions	6.9	2.8	2.3
of which			
Domestic shares	3.2	0.5	0.7
Non-banks	− 0.4	12.9	− 1.3
of which			
Domestic shares	− 6.6	1.8	0.0
Non-residents	3.9	7.7	5.6
Mutual fund shares			
Investment in specialised funds	15.6	11.7	20.7
Investment in retail funds	3.2	2.5	0.4
of which			
Equity funds	0.6	0.4	− 3.2

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their own bonds to the value of €13½ billion in net terms.

Issuance of corporate bonds mainly in the longer-term maturity segment

German enterprises took advantage of the favourable financing conditions and issued debt securities to the value of €3½ billion in net terms between July and September. On balance, these were solely bonds with maturities of more than one year. The majority of the issues was attributable to non-financial corporations.

Net redemptions by credit institutions continue

In the reporting quarter, domestic credit institutions followed the tendency seen in the previous quarter by reducing their capital market debt further, by €1½ billion, compared with €10 billion in the second quarter. This was probably chiefly due to the fact that banks' funding needs – which they can, moreover, primarily cover cheaply through deposits – were limited. In particular, they redeemed mortgage and public Pfandbriefe (€2½ billion and €1½ billion respectively). This contrasted with net issues of other bank debt securities which can be structured flexibly (€2 billion) and of debt securities by specialised credit institutions (€½ billion).

Domestic non-banks main buyers of debt securities

In the third quarter, German non-banks were the main buyers on the domestic bond market; they added paper worth €15½ billion to their portfolios. Most of these investors are likely to have been institutional investors. German credit institutions likewise invested in interest-bearing paper, making purchases worth €5 billion. The two investor groups' interest focused here on foreign securities (€13½ and €3½ billion respectively). Non-resident investors bought German debt securities for €1½ billion. On balance, these were solely securities issued by the private sector.

European equity markets post price losses

European equity markets sustained price losses compared with mid-year (see the chart on page 53). Buoyed by an accommodative monetary policy and positive economic data, several indices at first climbed to new highs in the course of July. However, given the subsequent unexpected economic downturn, the at times worsening geopolitical risks and an increased assessment of risk, equity prices subsequently fell on balance. In this setting, despite the expansionary monetary policy measures, the European Euro Stoxx index and the German CDAX share price index shed 5% and 5.9% respectively on balance compared with end-June.

Performance of bank stock prices affected by launch of banking union

Between early July and mid-November, the performance of European bank stock prices was strongly affected by market participants' expectations on how the most important banks would fare in the asset quality review and the stress test prior to the launch of the Single Supervisory Mechanism.[5] In the week before the results were published on 26 October, bank stocks posted gains of close to 6% (compared with 2.6% in the market as a whole) which

5 For information on the Single Supervisory Mechanism, see Deutsche Bundesbank, Launch of the banking union: the Single Supervisory Mechanism in Europe, Monthly Report, October 2014, pp 43-64.

were not eroded by price losses of just over 2% as a direct response to the publication. Although individual institutions sustained considerable net stock price losses after it became apparent that they had a high capital shortfall, the publication of the bank stress test results did not produce any major unpleasant surprises for the banking sector as a whole. In November in particular, however, discussions about more stringent regulation and about fines for interest rate and currency manipulation depressed European bank stock prices. All in all, bank stocks clearly underperformed the market as a whole, posting losses of 10% compared with the end of June.

Earnings expectations and risk premiums

The gloomier economic picture in the euro area was reflected only with a time lag in analysts' corporate earnings expectations. Up until the beginning of October, earnings expectations over a 12-month horizon were still rising slightly. They were subsequently adjusted downwards, however, and are now back at the end-June level. By contrast, long-term earnings expectations were below their mid-year levels as this report went to press. The price/earnings ratio of European stocks fell from 14.2 in June to 12.9, bringing it closer to its long-term average of 11.3. The implied equity risk premiums for the Euro Stoxx, which are calculated using a dividend discount model, rose by just under one percentage point to 9.5% in the reporting period.[6] A rise in implied stock market volatility and disagreement among analysts (also called "dispersion") indicate – like the higher risk premium – a reassessment of risk. Stock price uncertainty in the euro area was at a decidedly low level during the summer months and latterly rose towards its long-term average. Thus, there is much to suggest that euro-area investors' perception of risk grew on the whole in the course of the quarter under review.

Stock price gains in the USA and Japan

Stock prices in the United States performed better than in the euro area. As measured by the S&P 500, the US stock market was 4% up on its end-June level as this report went to press. All-time highs were recorded in July and September on the strength of a more robust economic outlook, surprisingly positive news from the labour market and support from monetary policy. Short-lived equity price declines in August and October were followed in both cases by a stronger recovery in the United States than in the euro area. Japanese stocks posted net price gains compared with the end of June (Nikkei +14.7%). However, these were ultimately due above all to the Bank of Japan's surprising announcement that it would be expanding its quantitative easing, which triggered a leap in prices.

Stock prices in major markets*

Weekly averages

Sources: Deutsche Börse AG, Thomson Reuters and Bundesbank calculations. * Price indices (taking no account of dividends. 1 Expected volatility in the next 30 days, calculated from option prices on the DAX.

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6 The rise in the equity risk premium from June is attributable to the fact that, when stock prices went down, earnings expectations did not fall to the same extent; moreover, yields on risk-free alternative investments declined. The high level of the equity risk premium in the euro area compared with the historical average and other markets is due to a combination of high dividend returns, high medium-term expected earnings growth and the currently extremely low yield on risk-free alternative investments.

Major items of the balance of payments

€ billion

Item	2013 Q3r	2014 Q2r	2014 Q3p
I Current account	+ 38.9	+ 46.3	+ 52.6
1 Goods1	+ 49.1	+ 55.4	+ 61.0
2 Services2	− 17.9	− 8.7	− 18.2
3 Primary income	+ 17.2	+ 6.6	+ 17.9
4 Secondary income	− 9.6	− 6.9	− 8.2
II Capital account	+ 0.4	+ 0.6	+ 0.9
III Financial account (increase: +)	+ 62.2	+ 64.2	+ 78.7
1 Direct investment	+ 3.6	+ 15.8	+ 26.8
Domestic investment abroad	+ 8.6	+ 23.2	+ 19.3
Foreign investment in the reporting country	+ 4.9	+ 7.4	− 7.4
2 Portfolio investment	+ 38.4	+ 22.7	+ 22.6
Domestic investment in foreign securities	+ 32.6	+ 41.3	+ 26.6
Shares3	+ 8.7	+ 4.9	− 0.1
Investment fund shares4	+ 7.7	+ 8.6	+ 12.8
of which Money market fund shares	+ 0.7	− 2.0	+ 2.5
Long-term debt securities5	+ 16.6	+ 27.6	+ 15.6
of which Denominated in euro6	+ 7.8	+ 23.9	+ 11.5
Short-term debt securities7	− 0.3	+ 0.2	− 1.6
Foreign investment in domestic debt securities	− 5.7	+ 18.6	+ 4.1
Shares3	+ 4.0	+ 7.7	+ 5.5
Investment fund shares	+ 1.2	+ 0.7	− 3.2
Long-term debt securities5	− 5.3	+ 11.0	− 6.9
of which Public bonds and notes8	+ 4.3	+ 9.7	− 6.4
Short-term debt securities7	− 5.6	− 0.6	+ 8.6
3 Financial derivatives9	+ 1.6	+ 9.0	+ 6.9
4 Other investment10	+ 19.4	+ 17.3	+ 22.1
Monetary financial institutions	+ 15.4	+ 41.8	− 27.1
Enterprises and households11	− 5.3	− 4.0	− 2.4
General government	+ 11.2	− 3.5	+ 8.2
Bundesbank	− 2.0	− 17.1	+ 43.4
5 Reserve assets12	− 0.8	− 0.6	+ 0.3
IV Errors and omissions13	+ 23.0	+ 17.2	+ 25.3

1 Excluding freight and insurance costs of foreign trade. **2** Including freight and insurance costs of foreign trade. **3** Including participation certificates. **4** Including reinvestment of earnings. **5** Up to and including 2012, without accrued interest. 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** Includes the following sectors: financial corporations (excluding monetary financial institutions) as well as non-financial corporations, households and non-profit institutions serving households. **12** Excluding allocation of special drawing rights and excluding changes due to value adjustments. **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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Slight pick-up in stock market funding and stock purchases

Issuing activity in the German equity market picked up somewhat in the third quarter. Domestic enterprises issued new shares totalling €6½ billion, the majority of which were listed. Of greater importance in terms of amount was, *inter alia*, the capital increase carried out by a telecommunications enterprise. The volume of foreign equities outstanding in the German market climbed by €½ billion. Equities were purchased primarily by foreign investors (€5½ billion) and domestic credit institutions (€2½ billion). By contrast, domestic non-banks sold equities to the value of €1½ billion.[7]

Sales and purchases of investment fund shares

During the quarter under review, domestic investment companies recorded inflows of €21 billion, after raising funds totalling €14 billion in the previous three-month period. The fresh funds mainly accrued to specialised funds reserved for institutional investors (€20½ billion). Among the asset classes, it was mainly mixed securities funds (€10½ billion) and bond funds (€8 billion) that placed new shares on the market. Foreign funds distributed in the German market attracted new resources totalling €13 billion net in the third quarter of 2014. Domestic non-banks were the main buyers, adding mutual fund shares worth €35½ billion to their portfolios. These were domestic shares for the most part. Domestic credit institutions purchased investment fund shares for €1½ billion, while foreign investors sold mutual fund shares worth €3 billion.

Direct investment

Capital exports in direct investment

As in cross-border portfolio transactions, which recorded a net outflow of funds totalling €22½ billion, net capital exports amounting to €27 billion were registered in the form of direct investment in the third quarter of 2014.

German direct investment abroad

The largest contributing factor was the comparatively high level of funding provided by German enterprises to their subsidiaries abroad,

7 For further details, see under Direct investment.

Structure and activity of foreign affiliates of German investors: Results of outward FATS*

Rationale and methodology

When analysing globalisation and cross-border value chains, the activities of and relationships between internationally active groups and the foreign affiliates which they control are of considerable interest. If policy-makers are to provide appropriate responses to the phenomenon of globalisation they need to have recourse to a reliable statistical database. To achieve this objective, an EU Regulation[1] was adopted which effectively obliges all member states to provide Eurostat, the Statistical Office of the European Union (EU), annually with key data on cross-border controlled enterprises on a harmonised basis. These data simultaneously form a key part of the toolbox for analysing the European single market and the interconnectedness of economies arising from the European integration process.

FATS make a distinction between key data pertaining to enterprises in Germany controlled by foreign investors (inward FATS) and key data relating to enterprises abroad that are ultimately controlled by German investors (outward FATS). In Germany, responsibility for these statistics is divided between the Federal Statistical Office (inward FATS) and the Deutsche Bundesbank (outward FATS).[2]

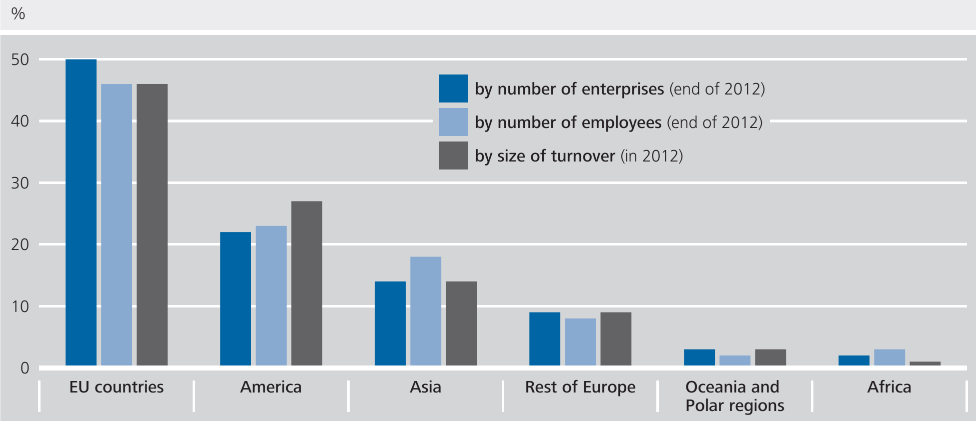
At present, the outward FATS focus on three key metrics, namely the number of foreign affiliates, the number of employees and the annual turnover of these enterprises. As a database, use is made of the "foreign direct investment stock statistics" which are compiled by the Bundesbank each year on the basis of the Foreign Trade and Payments Regulation *(Außenwirtschaftsverordnung)*. To avoid double-counting in the EU aggregates, only the direct or indirect majority stakes of German investors who are also headquartered in Germany are included when calculating the FATS variables. As the foreign direct investment stock statistics are subject to a reporting threshold for the total assets of direct investment enterprises, the outward FATS similarly do not take into account any foreign affiliates with total assets up to and including the amount (in converted terms) of €3 million.

Empirical findings

The latest available data are for the reporting year 2012. At year-end, the data identified 27,000 enterprises abroad as being ultimately controlled by German investors. Half of these enterprises were foreign affiliates domiciled in EU countries, a circumstance reflecting the importance to many investors of close proximity to sales markets as a decision-making criterion (see the chart on page 56). Some 22% of these foreign affiliates were domiciled in America, of which almost 3,900 enterprises – in other words, nearly two-thirds – were based in the United States. Foreign affiliates controlled by German investors and located in Asia are growing in importance, the main emphasis being on the People's Republic of China where just under 1,400 enterprises were domiciled at

* Foreign subsidiaries including branches and permanent establishments abroad. FATS: Foreign Affiliates Statistics; statistics on the structure and activity of foreign affiliates.
1 Regulation (EC) No 716/2007 of the European Parliament and of the Council of 20 June 2007 on Community statistics on the structure and activity of foreign affiliates.
2 See P Schmidt, B Waldmüller and B Stejskal-Passler (2009), Future statistics on foreign-controlled enterprises in Germany (inward FATS) and subsidiaries of German residents investing abroad (outward FATS), in AStA Wirtschafts- und Sozialstatistisches Archiv (ie AStA Economic and Social Statistics Archive), Volume 3, Issue 3, pp 169 ff (in German only).

Regional breakdown of foreign affiliates of German investors*



Source: Bundesbank calculations based on the statistics on the structure and activity of foreign affiliates of German investors (outward FATs).
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the end of 2012. Foreign affiliates in Oceania and the Polar regions, as well as in Africa, play only a minor role for German investors, viewed in terms of holding a majority stake.

A slightly different regional breakdown becomes apparent if the focus is placed on the number of persons employed by these foreign affiliates. The majority of the 5.1 million total number of employees are concentrated in EU countries or Europe as a whole (54%). However, if a comparison is made with the number of enterprises, this share works out at 5 percentage points less. Compared with the number of enterprises, Asian countries were of relatively greater significance at the end of 2012 given that they represent a favourable choice for wage-intensive production on account of the lower wage costs or local content requirements. Of the 900,000 total number of employees concentrated in Asia, well above half of these worked for German foreign affiliates based in the People's Republic of China and India alone. The growing interest displayed by German investors in Asian countries is also demonstrated by the reduced proportion of their foreign affiliates' workforce located in EU countries. Between 2009 and 2012, this block went down by 3 percentage points from 49% to 46%, following a shift to the highly dynamic Asian region.

In 2012, the volume of turnover generated by German foreign affiliates totalled €1.9 trillion. More than €1 trillion of this amount was attributable to affiliates in European countries. Accounting for 27% of this turnover, foreign affiliates in American countries, most notably the United States, Brazil, Canada and Mexico, were nevertheless also of relatively major importance. Asian countries' share of turnover stood at 14%, more than half of which was generated in the People's Republic of China and Japan. Between 2009 and 2012, the turnover of German foreign affiliates in this region almost doubled, whereas turnover in the EU was up by just 14%.

Information on the activities of foreign affiliates – broken down by individual sector in line with the internationally harmonised classification of economic activities, NACE[3] Rev 2 – is also available. At the end of 2012, just under 30% of German foreign affiliates

3 Nomenclature générale des activités économiques dans les Communautés européennes; Statistical classification of economic activities in the European Community.

were assignable to section G covering wholesale and retail trade; repair of motor vehicles and motorcycles (see adjacent table). As regards manufacturing abroad, German investors were likewise found to have a key stake in 7,200 foreign affiliates at the end of 2012. The number of German foreign affiliates involved in financial and insurance activities remained broadly constant with 2,400 foreign affiliates between 2009 and 2012, doubtless also on account of the financial crisis.

At the end of 2012, German foreign affiliates employed almost 2.4 million individuals in the manufacturing sector, most of whom were engaged in the manufacture of motor vehicles, trailers and semi-trailers as well as of fabricated metal products and machinery. Just under one-quarter of all employees (1.2 million persons) worked for foreign affiliates operating in the wholesale and retail trade. While the bulk of the workforce in the manufacturing sector was employed by foreign affiliates in non-EU countries (62%), a much larger share of foreign affiliates' workforce was employed in the wholesale and retail trade in the EU (59%).

In the case of the manufacturing industry as well as the wholesale and retail trade, 35% of annual turnover in 2012 was generated by foreign enterprises controlled by German investors. These sectors also saw above-average growth in turnover between 2009 and 2012. In 2012, just under €210 billion turnover was generated by foreign affiliates engaged in financial and insurance activities; this represented an 11% share of the total turnover of all foreign affiliates.[4]

4 Detailed results broken down by country and economic sector for the period 2009 to 2012 can be found at www.bundesbank.de in the internet publication "Structure and activity of foreign affiliates of German investors (outward FATS)" under Statistics/External sector/Foreign affiliates (FATS).

Structure and activity of foreign affiliates of German investors by economic activity of the foreign affiliates

	Number of		
	Enterprises	Employees (in thousands)	Turnover (in € billion)
Economic activity of the foreign affiliates	At the end of 2012		In 2012
All economic activities[1] *of which*	26,997	5,055	1,896
C Manufacturing	7,174	2,373	670
of which			
Refined petroleum products, manufacture of chemicals and pharmaceuticals and manufacture of rubber and plastic products	1,690	433	183
Fabricated metal products and machinery	2,456	622	145
of which			
Manufacture of basic metals and fabricated metal products	777	144	32
Machinery	1,174	293	71
Total vehicles and other transport equipment	1,265	740	236
of which			
Manufacture of motor vehicles, trailers and semi-trailers	1,151	710	230
G Wholesale and retail trade; maintenance and repair of motor vehicles and motorcycles	7,877	1,207	671
of which			
Wholesale trade (excluding motor vehicles and motorcycles)	6,305	622	340
Retail trade (excluding motor vehicles and motorcycles)	800	485	118
H Transportation and storage	1,273	397	97
J Information and communication	645	205	60
K Financial and insurance activities	2,398	244	207
L Real estate activities	1,262	5	5
M Professional, scientific and technical activities, veterinary activities	3,122	91	16
Q Health and social work	1,143	73	9

1 Excluding section "A Agriculture, forestry and fishing" and section "O Public administration, defence and compulsory social security".
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which amounted to €19½ billion in the third quarter. German enterprises primarily increased their equity capital (€12 billion), in particular through reinvested earnings. At the same time, they also stepped up intra-group lending (€7½ billion). Here, there was an expansion of financial credits while trade credits were cut back. Major destinations for German direct investment were the Netherlands (€5½ billion), the United Kingdom (€5½ billion) and France (€4 billion). In Russia, on the other hand, equity capital was reduced (€1 billion).

Foreign direct investment in Germany

Foreign investors scaled back their direct investment in Germany (€7½ billion) in the third quarter of 2014. Equity capital was built up (€2½ billion) primarily in the form of reinvested earnings; on the other hand, intra-group loans were repaid (€10 billion). This was largely due to the financial relationships with the Netherlands. Here, chiefly domestic affiliates repaid previously granted direct investment loans to their foreign parent companies (€8½ billion) in the third quarter.