The pronounced rise and fall in Germany's current account surplus vis-à-vis its euro-area partner countries between 1999 and 2011

The current account balance is one of the indicators in the EU's macroeconomic surveillance procedure that was introduced last year in order to identify the build-up of imbalances within and between the European economies at an early stage.[1] A high surplus or deficit position vis-à-vis the euro-area partner countries has major economic policy implications, as the exchange rate is no longer available as an adjustment instrument. It is worth mentioning in this context that the German economy's current account surplus vis-à-vis the rest of the euro area has decreased considerably from a peak of almost €108 billion in 2007 to just under €57 billion in 2011.[2] Thus after growing for some years from an almost balanced position in 1999, the current account surplus has fallen by almost half since the beginning of the financial and economic crisis.

During the build-up of the surplus from 1999 to 2007, Germany's current account balance vis-à-vis the rest of the euro area increased on average by €12½ billion per year. Three-quarters of this came from growth in net income from cross-border merchandise trade. The only other quantitatively significant item was the improvement in German investment income from euro-area countries relative to the expenditure on euro-area countries' investments in Germany. It is notable that the average annual reduction in the current account surplus since 2008 has not only been of the same magnitude but has also entailed virtually no shift in the relative contributions of the trade and investment income sub-accounts.[3]

As regards merchandise trade, the accumulation of the German current account surplus between 1999 and 2007 can be explained by the fact that economic growth varied across the euro-area countries in terms of pace and profile. Given the dull momentum of Germany's domestic economic activity at the time, domestic enterprises focused on international markets. The rest of the euro area, like many other regions, often promised better sales opportunities. Conversely, the German market was rather unattractive for foreign companies. The annual increase in the surplus generated from cross-border merchandise trade would even have been around a fifth higher if import prices had not risen twice as fast as export prices on average.

Furthermore, the period under review coincided with a drive by German companies to raise their profitability to the level demanded by international investors. They achieved this *inter alia* by shifting production to other European countries through direct investment and the acquisition of equity stakes. Up until 2003, however, the German economy's investments in the euro area did not yield, on average, as much profit as foreign investment in Germany. One significant factor in the build-up of the current account surplus was that the deficit on the investment income sub-account was narrowed continuously from 2004 – amid

1 See also Deutsche Bundesbank, Germany's external position against the background of increasing economic policy surveillance, Monthly Report, October 2011, pp 41-59.
2 This analysis is based uniformly on figures for the euro area as currently defined, ie the euro area (17).
3 The multi-year average reveals the underlying trends in the sub-accounts and their structural impact on the evolution of the overall current account balance. However, this average conceals the fact that the contribution of net investment income not only fluctuated considerably from one year to the next, but also changed signs. To a lesser degree, this was also true of the other components of invisibles, whereas the balance on trade in goods was fairly steady.

only small changes in Germany's net external asset position – and turned into a surplus in 2006-7.

The fall in the surplus since 2008 not only extends over a very pronounced business cycle, but also includes the point in time at which the German economy became the growth locomotive for the entire euro area. The end of the last upturn in the first quarter of 2008 triggered a marked correction in the trade balance. Up until mid-2009, the German economy's trade surplus vis-à-vis the rest of the euro area declined by around one-third. In addition to the slump in world trade following the Lehman shock, which hit Germany harder than the other euro-area countries, this owed something to the stimulus measures implemented in order to stabilise the level of economic activity, which also provided a knock-on boost to partner countries through German domestic demand.[4] The temporary substantial improvement in the terms of trade during the recession lessened the contraction in the trade surplus that would have resulted *per se* from the changes in trade volumes by three-tenths in 2009.

When global trade rebounded sharply from mid-2009 onwards, German firms' merchandise trade with customers from euro-area countries likewise picked up. Part of the recession-induced fall in the trade account surplus with partner countries was quickly recouped. Thereafter, a dampening effect on the trade balance resulted from the fact that the German economy recovered significantly faster than the rest of the euro area. The imports of intermediate goods from other European countries were boosted because many suppliers located there participated in German exporters' strong sales performance, in particular in the rapidly expanding Asian markets. Another factor was that German demand for

Current account balance vis-à-vis other euro-area countries

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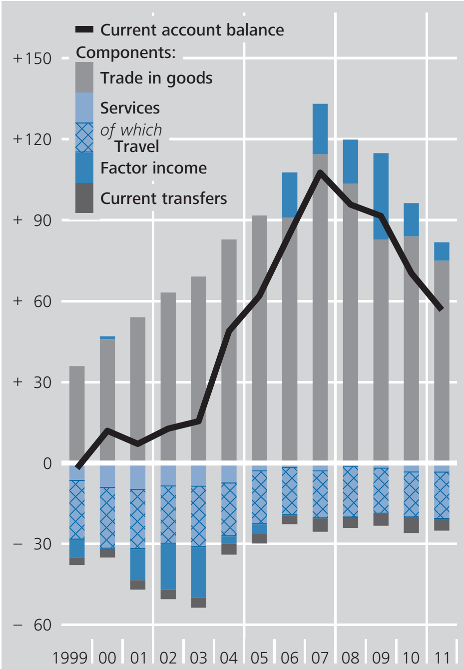

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capital goods, including cars (which likewise have a high import content), shot up. By contrast, imported consumer goods and services made a rather small contribution. In total, Germany's growth lead, which averaged an annualised 2¼ percentage points, is likely to have brought the other euro-area countries an estimated additional export volume of some €12 billion per year since the beginning of the recovery in mid-2009.[5] Conversely, the German economy

4 The car scrappage premium, for example, had a perceptible impact, stimulating the import of small and medium sized vehicles in the first half of 2009.
5 The basis of the calculations is a hypothetical alternative scenario in which since mid-2009 the German economy would grow at the same pace as the euro area excluding Germany. Here it is taken into consideration that a flatter GDP path would have changed the demand for intermediate goods as well as the growth profile of domestic GDP use components. With regard to the trade effects, this is quantitatively significant due to the differences in the import content of the demand components. See also Deutsche Bundesbank, The transmission and regional distribution of the German economy's cyclical impulses within Europe, Monthly Report, March 2011, pp 22-23.

failed to match the strong export performance it had achieved in the last upturn in many parts of the euro area owing to the sluggish economic momentum there.

The German economy's external assets invested in the euro area have increased by more than a quarter since 2008, whilst its corresponding liabilities showed only a small increase. In spite of the significant change in investment volume, the substantial decline in the yield on foreign assets again led to a sharp contraction of the investment income surplus.[6] By contrast, the expenditures on liabilities to other euro-area residents remained fairly stable, with the exception of 2009.

Overall, the sharp fluctuations in Germany's current account balance in relation to its euro-area partners can be attributed to the complex interaction of diverse economic processes and mechanisms; these relate not only to cyclical developments and foreign trade but also, via cross-border investment decisions and their associated income streams, to the financial sphere. Although the current account balance is influenced by the structural economic conditions in the medium to long term, it is largely immune to any direct steering through short-run political macro-management.