# Foreign trade and payments

## Foreign trade and current account

*Export trends*

After sustaining a steep decline towards the end of last year, a development which contributed significantly to a clouding of the overall economic picture, German exports seem to have picked up again in the first few months of this year. At all events, they did not decrease further but actually increased (in seasonally adjusted terms) for the first time in a while. The downward trend in orders received from abroad did not persist into the first quarter of this year either. Stabilising trends in the global economic environment suggest that German exports will continue to recover in the near future. The results of recent surveys on the export expectations of German industry point in a similar direction: positive views once again predominate, after the exceedingly negative judgements expressed by the enterprises surveyed in the closing months of 1998.

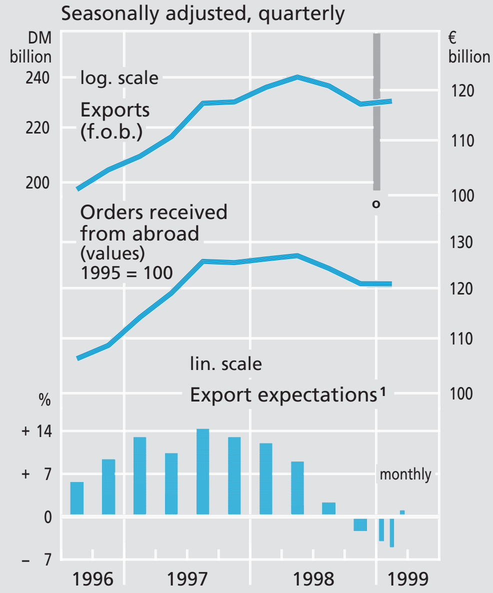
*Further rise in exports*

The value of German exports grew by a seasonally adjusted ½ % in the first quarter of this year compared with the last quarter of 1998. Given the slight decrease in export prices in the period under review, the increase in real export volume was actually somewhat greater, at approximately 1%. Even so, German exports were still below their corresponding level a year earlier; to this extent, export activity remained subdued. Nevertheless, the downward trend in German exports appears to have levelled off. The groundwork for this development was laid by German business with its successful restructuring and rationalisation measures and not least by management and labour through their adherence to a moderate wage policy until last year. In addition, the strength of the dollar and other leading currencies in the first few months of 1999 helped ease the situation. It would be hazardous, however, to rely exclusively on the continuation of this trend and to ease up on comprehensive efforts to improve competitiveness "from within". From this standpoint the recent wage settlements of 1999 are to be viewed critically – as is the still inadequate progress in implementing urgently needed reforms.

*Focus: euro area and US*

The importance of undertaking structural adjustments domestically was underscored not least by the fact that the most powerful economic stimuli came from other countries in the euro area. In January-February, Germany exported, in seasonally adjusted terms, approximately 1½ % more goods to this area than in the previous period; in the fourth quarter of 1998 an increase of only ½ % was recorded. By contrast, exports to "third countries" tended, on the whole, to be weak; here exports in the first two months of 1999 fell by a further 2½ % (seasonally adjusted), after sustaining a drop of 4½ % in the final quarter of last year. An important reason for this decline in exports was the markedly weak growth in the British economy. As a result, German exports to the United Kingdom fell appreciably despite the strength of the pound. However, exports to the US market, which had been growing relatively strongly, were again quite buoyant in the opening months of 1999. Finally, it is also worth noting that German exports to the emerging markets in South-East Asia increased significantly for the first time in 18 months, although exports to this region are still one-quarter down on the previous year's level.

Export trend




1 Values are taken from the ifo business survey and cover Germany as a whole. Balances are from positive and negative company reports. — o From 1999 on all data in euro.

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*Imports somewhat weaker overall*

Unlike exports, imports decreased further in value in the first three months of this year; in seasonally adjusted terms they fell in the first quarter of 1999 by 1½ % compared with the preceding quarter. However, this decrease was partly prompted by a further fall in import prices. After adjustment for price changes, imports were only about 1% below those of the last quarter of 1998. The year-on-year increase in real imports was just under 1½ %, a result in keeping with the muted level of domestic production in the first quarter of 1999.

The effect of the import price trend on (nominal) imports is also evident from the shifts in

## Regional breakdown of foreign trade

January–February 1999, seasonally adjusted

| Group of countries/ Country | Exports: € billion | Exports: Change from Nov. – Dec. 1998 in % | Imports: € billion | Imports: Change from Nov. – Dec. 1998 in % |
|---|---|---|---|---|
| Industrial countries | 61.4 | + 1.6 | 50.9 | + 0.2 |
| EU countries | 45.5 | + 1.4 | 36.1 | – 0.9 |
| EMU countries | 34.6 | + 1.4 | 29.4 | + 0.6 |
| Austria | 4.2 | – 2.5 | 2.8 | + 2.8 |
| Belgium/ Luxembourg | 4.5 | – 0.6 | 3.3 | – 14.5 |
| Finland | 0.9 | + 4.1 | 0.8 | + 13.6 |
| France | 8.1 | + 2.8 | 6.9 | + 1.0 |
| Ireland | 0.5 | – 5.3 | 1.2 | + 49.7 |
| Italy | 6.0 | + 5.6 | 5.2 | – 1.6 |
| Netherlands | 5.2 | + 0.9 | 5.3 | – 1.8 |
| Portugal | 0.9 | – 5.5 | 0.8 | – 0.7 |
| Spain | 3.3 | – 0.6 | 2.3 | + 5.3 |
| Other EU countries | | | | |
| Denmark | 1.4 | + 4.6 | 1.1 | + 7.3 |
| Greece | 0.6 | – 3.4 | 0.3 | + 0.0 |
| Sweden | 1.9 | + 3.4 | 1.3 | – 1.2 |
| United Kingdom | 6.7 | – 3.8 | 4.1 | – 10.1 |
| Other industrial countries | 15.9 | + 2.2 | 14.8 | + 3.0 |
| of which | | | | |
| United States | 7.6 | + 1.2 | 5.7 | – 3.4 |
| Japan | 1.6 | + 10.7 | 3.4 | + 1.7 |
| Countries in transition | 9.1 | + 5.1 | 9.2 | + 0.4 |
| of which | | | | |
| Countries in central and eastern Europe | 7.9 | + 2.6 | 7.3 | + 4.1 |
| China 2 | 1.2 | + 33.9 | 1.9 | – 3.4 |
| Developing countries | 8.5 | + 0.8 | 7.3 | – 1.4 |
| of which | | | | |
| OPEC countries | 1.5 | – 3.4 | 0.8 | – 13.9 |
| Emerging markets in South-East Asia | 2.9 | + 10.1 | 3.3 | – 0.9 |
| All countries 1 | 79.0 | + 1.3 | 67.2 | – 1.5 |

**1** The totals for the comparative period of 1998 include annual revisions which are not yet available in a regional breakdown. — **2** Excluding Hong Kong.

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*Price distortions affect regional breakdown*

the regional breakdown of German imports. Thus, in the first two months of this year, the value of German imports from other EMU countries rose further, namely by just over ½% (seasonally adjusted); these countries were presumably less affected by price reductions and are thus better indicators of real growth in import volume. By contrast, the value of imports from third countries clearly decreased. An important reason for this was the lower import prices for energy and raw materials from the developing countries and from other suppliers. The persistent decline in the value of imports from the emerging markets in South-East Asia is also more likely a reflection of trends in particular import prices than of trends in the corresponding import volumes – even if this decline would appear at first glance to belie the improved competitiveness of their economies following the substantial depreciation of their currencies. These distortions will become less important in the near future, as several currencies in the Asian crisis region have clearly stabilised again and price trends in the oil markets were reversed in the spring. Over the long term, these two changes will not leave the corresponding German import prices unaffected and will lower the real income gains of consumers and investors that resulted from the recent improvement in terms of trade.

*Trade balance*

The slight upturn in exports, along with a further decline in imports, resulted in another increase in Germany's trade surplus in the first quarter of 1999. Seasonally adjusted, the nominal export surplus in the first quarter of 1999 amounted to € 17½ billion compared with the equivalent of just under € 15½ billion in the preceding quarter.

*Current account*

At the same time, however, invisible current transactions incurred a deficit of similar proportions. The deficit on services in the first quarter was actually somewhat greater than in the preceding quarter. Current transfers abroad, however, were considerably lower. Thus Germany's total current account ran a slight, seasonally adjusted surplus of € ½ billion compared with a deficit equivalent to just under € 4 billion in the final quarter of 1998.

### Current account

€ billion; seasonally adjusted

| Item | 1998 3rd qtr | 1998 4th qtr | 1999 1st qtr |
|---|---|---|---|
| 1. Foreign trade | | | |
| Exports (f.o.b.) | 121.5 | 117.7 | 118.4 |
| Imports (c.i.f.) | 104.9 | 102.5 | 100.8 |
| Balance | 16.6 | 15.3 | 17.5 |
| 2. Services (balance) | – 7.4 | – 8.4 | – 9.2 |
| of which | | | |
| Foreign travel (balance) | – 6.9 | – 7.2 | – 7.3 |
| 3. Factor income (balance) | – 0.4 | – 3.0 | – 3.2 |
| of which | | | |
| Investment income (balance) | – 0.2 | – 2.8 | – 3.0 |
| 4. Current transfers (balance) | – 6.6 | – 7.2 | – 4.0 |
| Balance on current account 1 | 1.7 | – 3.9 | 0.6 |

1 Includes supplementary trade items.

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## Financial transactions

*Financial transactions affected by EMU*

In the first quarter of 1999, German financial transactions with non-residents were influenced above all by the start of European economic and monetary union (EMU). In many cases, transactions within the single currency area predominated;[1] they may be considered the first harbingers of the single financial market that is still emerging – and not least because euro-denominated assets played a leading role in these transactions. With the disappearance of exchange rate risk, differences in interest rates and financial standing have evidently become more important criteria for investment decisions. Competition among the national financial markets within EMU has become more fierce. This has also entailed certain adjustments for the German market. Inflows of funds, particularly those arising from trade in Federal bonds, were significantly smaller than in previous years; at the same time, German banks raised a substantial amount of funds through the sale of bonds and notes to non-residents and acquired large sums of liquid funds from non-residents through short-term credit transactions.

*Portfolio transactions*

In the first quarter of 1999, capital exports arising from portfolio transactions with non-residents rose to € 38½ billion net; in the last three months of 1998 a net equivalent of € 6½ billion was exported.[2]

1 The German balance of payments will continue to show all transactions with non-residents. Thus financial transactions involving counterparties from other EMU countries as well as transactions involving counterparties domiciled outside the euro area are posted under "Financial transactions".
2 However, any attempt to compare the first quarter of 1999 with the preceding quarter must take into account the fact that in November 1998 a corporate merger posted net inflows as a result of portfolio transactions – and corresponding capital exports as a result of direct investment – amounting to the equivalent of over € 25 billion.

## Major items of the balance of payments

€ billion

| Item | 1998 1st qtr | 1998 4th qtr | 1999 1st qtr |
|---|---|---|---|
| I. Current account | | | |
| 1. Foreign trade | | | |
| Exports (f.o.b.) | 119.3 | 123.7 | 116.7 |
| Imports (c.i.f.) | 104.9 | 106.9 | 100.8 |
| Balance | + 14.4 | + 16.8 | + 15.9 |
| 2. Services (balance) | – 7.4 | – 6.3 | – 8.5 |
| 3. Factor income (balance) | – 2.1 | – 2.5 | – 4.0 |
| 4. Current transfers (balance) | – 8.1 | – 7.0 | – 5.4 |
| Balance on current account 1 | – 3.4 | + 0.5 | – 2.5 |
| II. Balance of capital transfers | + 0.3 | – 0.0 | + 0.2 |
| III. Financial account 2 | | | |
| Direct investment | – 2.7 | – 38.5 | – 10.9 |
| Portfolio investment | – 10.8 | – 6.3 | – 38.7 |
| German investment abroad | – 33.6 | – 33.2 | – 58.6 |
| Foreign investment in Germany | + 22.8 | + 26.9 | + 20.0 |
| Financial derivatives | – 2.2 | – 2.2 | + 1.1 |
| Credit transactions 3 | + 28.8 | + 33.2 | + 5.3 |
| Overall balance on financial account | + 13.0 | – 13.9 | – 43.2 |
| IV. Change in the monetary reserves at transaction values (increase: –) 4 | – 1.3 | – 0.6 | + 13.3 |
| V. Balance of unclassifiable transactions | – 8.6 | + 14.0 | + 32.1 |

**1** Includes supplementary trade items. — **2** Net capital exports: –. — **3** Including Bundesbank investment and other public and private investment. — **4** Excluding allocation of SDRs and changes due to value adjustments.

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*German investment in foreign ...*

In particular, German investors showed significantly greater interest in foreign securities than previously. In the period under review they acquired foreign paper worth a total of € 58½ billion compared with the equivalent of € 33 billion in the fourth quarter of 1998. Shares (€ 17½ billion) as well as bonds and notes (€ 36 billion) were in greater demand. Amid all the relative changes, the heavy demand for foreign shares on the part of German savers is especially noteworthy; at all events, the rise in German purchases of foreign shares amounted to just under 80 % relative to the preceding quarter. It is possible that the economic and earnings prospects of foreign enterprises were assessed more optimistically during the period under review than they had been in the autumn of last year, when a marked slowdown in economic growth had been forecast, especially for the United States. However, German investors also stepped up their acquisition of shares in enterprises from other euro countries. After the disappearance of exchange rate risks within the single currency area, it was to be expected that portfolios would become more regionally diversified. It may be assumed, however, that in the case of many savers these investments were probably not made directly at the corresponding foreign stock exchange but via investment funds, which continue to attract measurably greater sums.

*... shares*

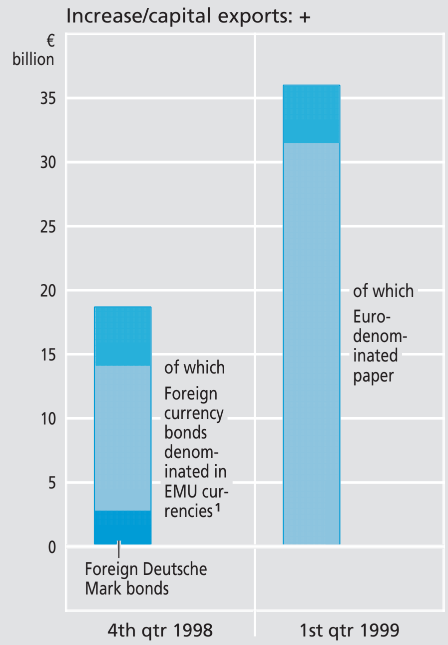
*... bonds and notes*

In addition to shares, foreign bonds and notes were also greatly favoured by German investors. Although pound and dollar-denominated paper secured a relative advantage owing to the increasing difference between UK and US interest rates and those of the euro area, it was euro-denominated bonds that were primarily in demand. Almost 90 % of the paper acquired was denominated in euro, two-thirds originating in other EMU countries. The fact that purchases continued to focus on the euro-denominated issues of other EMU countries is significant since the typical advantages associated with interest rate convergence, such as those expected in the run-up to EMU, – i.e. the prospect of short-term profits – can no longer have played the dominant role in investor decisions that they had done up to the end of last year. However, with the complete disappearance of exchange rate risk within EMU, the remaining interest rate differentials probably influenced investors all the more strongly when choosing between the long-term public bonds of other EMU countries and German Federal government issues, the now established "benchmark" in the euro area. This might explain why investors – especially yield-sensitive investors, who react to even slight interest rate differentials – were more inclined to acquire foreign rather than German government securities. Evidently, investors regard the public bonds of EMU countries as very close substitutes.

*Foreign investment in German ...*

This thesis is also supported by the fact that international investors purchased Federal bonds only to a relatively limited extent at the beginning of this year (€ 6 billion). The probable reason for this lack of demand is that Federal bonds offer a lower rate of interest than other public bonds in the euro area, owing – among other factors – to their function as a "benchmark". By contrast, foreign demand for bank bonds, which certainly bore higher interest than Federal bonds, was far stronger (€ 26 billion). Of these, mortgage and communal bonds aroused the greatest interest among foreign investors. This can certainly be attributed, in part, to the increased effort made in the past few years by German issuing houses to provide investors with sufficient information on these little-known investment opportunities and to concentrate more on the wishes of international investors when designing issues. With a total influx of € 32 billion, the quantity of foreign funds converging on the German bond market in the first three months of 1999 was three times greater than in the preceding quarter.

German investment in foreign bonds




1 Including ECU.

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## Financial transactions

€ billion, net capital exports: –

| Item | 1998 1st qtr | 1998 4th qtr | 1999 1st qtr |
|---|---|---|---|
| 1. Direct investment | – 2.7 | – 38.5 | – 10.9 |
| German investment abroad | – 27.3 | – 35.8 | – 20.8 |
| Foreign investment in Germany | + 24.6 | – 2.7 | + 9.9 |
| 2. Portfolio investment | – 10.8 | – 6.3 | – 38.7 |
| German investment abroad | – 33.6 | – 33.2 | – 58.6 |
| Shares | – 16.9 | – 9.9 | – 17.6 |
| Investment fund certificates | – 3.5 | – 1.4 | – 4.5 |
| Bonds and notes | – 12.3 | – 18.7 | – 36.0 |
| Money market paper | – 0.9 | – 3.2 | – 0.5 |
| Foreign investment in Germany | + 22.8 | + 26.9 | + 20.0 |
| Shares | – 0.1 | + 19.4 | – 15.2 |
| Investment fund certificates | + 0.2 | – 0.7 | + 1.6 |
| Bonds and notes | + 18.6 | + 11.0 | + 32.1 |
| Money market paper | + 4.1 | – 2.8 | + 1.5 |
| 3. Financial derivatives | – 2.2 | – 2.2 | + 1.1 |
| 4. Credit transactions | + 29.6 | + 33.8 | + 5.6 |
| Credit institutions | + 45.1 | + 14.1 | + 21.6 |
| Long-term | + 1.5 | + 0.8 | + 4.0 |
| Short-term | + 43.6 | + 13.4 | + 17.6 |
| Enterprises and individuals | – 13.8 | + 16.7 | + 14.0 |
| Long-term | – 0.1 | + 0.4 | + 1.8 |
| Short-term | – 13.7 | + 16.4 | + 12.2 |
| General government | – 1.8 | + 1.4 | – 0.5 |
| Long-term | – 0.6 | – 2.9 | – 2.4 |
| Short-term | – 1.2 | + 4.3 | + 2.0 |
| Bundesbank | + 0.1 | + 1.5 | – 29.5 |
| 5. Other investment | – 0.9 | – 0.6 | – 0.2 |
| 6. Balance of all statistically recorded capital flows | + 13.0 | – 13.9 | – 43.2 |
| Memo item Change in the monetary reserves at transaction values (increase: –) 1 | – 1.3 | – 0.6 | + 13.3 |

1 Excluding allocation of SDRs and changes due to value adjustments.

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*... shares*

Unlike bond issues by German banks, German shares continued to be treated with caution by foreign investors in the period under review. Having already shifted to the selling side in the preceding quarter – if the shares transferred in connection with the merger of two large enterprises in November are excluded – foreign investors sold shares in German enterprises worth € 15 billion net. The relatively weak growth prospects for German business within the euro area were presumably one reason why foreign investors temporarily sought opportunities elsewhere. At all events, in the first two months of this year – those for which ECB data are so far available – the euro area as a whole raised € 8½ billion worth of funds through the sale of shares to investors from "third countries", virtually the same amount as in the preceding two months, again disregarding the major transaction previously mentioned.

*Deficit on direct investment*

In the period under review, net capital outflows from the German market were also recorded outside the field of portfolio transactions. Capital outflows as a result of direct investment amounted to € 11 billion.[3] The decisive factor here was an increase of just under € 21 billion in foreign investment by German enterprises; most of this consisted in direct investment loans. As for foreign direct investment in Germany (€ 10 billion), short-term financial and trade credits among affiliated enterprises also predominated in the first three months of 1999. Owing to a

3 Here, too, the comparison with the preceding quarter (when there was a deficit equivalent to € 38½ billion) is of only limited validity on account of the major transaction already mentioned.

change in the definition of the term "direct investment" in force since the beginning of this year, these loans are now recorded under direct investment and no longer under credit transactions.

*External position of the banking system still in deficit*

The (unsecuritised) net external position of German credit institutions declined considerably in the first quarter of this year; the decline reflects, and is largely the inverse consequence of, the transactions listed in the current and financial accounts and described above. The settlement of foreign payments either brought German banks large-scale inflows of short-term deposits from abroad or led them to secure the corresponding credit there. As a result of these transactions, the net external position of the banks declined by a total of € 21½ billion.

*Evaluation of the changes in external financing structure*

Thus, in the final analysis, credit institutions "financed"[4] outflows from the German securities markets and net capital exports as a result of direct investment at least partially by taking up what are, in effect, short-term liabilities vis-à-vis foreign banks. It could be argued that such changes are detrimental to the financing structure of the German balance of payments. However, an argument against this interpretation is that net capital exports from the non-banking sector do not reflect so much the withdrawal of foreign investors from the German market as increased foreign investment by German residents. Especially where investment in other euro countries is concerned, the main reason for the rise was the aforementioned efforts to increase the regional diversification of portfolios after the exchange rate risk within monetary union had disappeared. In other words, it is part of the process of adjusting to the change in monetary conditions brought about by monetary union and will likely lead to a more balanced allocation of risk across the larger euro area. Finally, it must be recognised that different financing methods have involved, at most, marginal changes in the foreign currency position of the banking sector. Even so, the "maturity transformation" in the local currency represents an important function of credit institutions; it is, in the end, only natural that, in the process of creating a single financial market, cross-border positions also play a role within monetary union.

Capital outflows from the single monetary area to third countries and their financing would appear, however, to be marked by the transition to the euro. According to data on the financial transactions of EMU, a total of almost € 16 billion left the euro countries in the first two months of this year as a result of securities deals and direct investment. In addition, the unusually large negative entry under "unclassifiable transactions" in the EMU's balance of payments (just under € 25 billion) suggests considerable further outflows. The most important counterpart in the EMU financial account – as in the case of the German financial account – is short-term foreign borrowing by banks domiciled in the euro area. The total net external position of the banks in the euro area fell by € 53 billion at the beginning of the year. The possibility

4 Analysis was complicated by the large positive value for "errors and omissions", which point to unclassified transactions – presumably, first and foremost, in the non-banking sector.

## Balance of payments for the euro area

Balances in ECU/€ billion

| Item | 1998 Nov.–Dec. | 1999 Jan.–Feb. |
|---|---|---|
| Current account | + 12.5 | + 3.7 |
| Capital transfers | + 2.9 | + 2.7 |
| Balance of capital transfers 1 (Net capital exports: –) | + 21.0 | + 18.6 |
| of which | | |
| Direct investment | – 34.5 | – 7.2 |
| Portfolio investment | – 13.3 | – 8.7 |
| Credit transactions 2 | + 61.3 | + 34.7 |
| of which | | |
| Credit institutions | + 41.3 | + 52.9 |
| Balance of unclassifiable transactions | – 36.4 | – 24.9 |

**1** Values from January 1999 are not completely comparable with earlier data. — **2** Data for 1998 partially estimated. — Source: European Central Bank.

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that adjustments to a change in monetary conditions played a significant role in this drop cannot be ruled out; they will likely become less important with time. The changes in financing structure already described should be seen in the overall context of the balance of payments and not overemphasised since monetary union – when viewed over an entire year – generates a not inconsiderable current account surplus, which necessarily leads to greater foreign investment.

*External transactions of the Deutsche Bundesbank*

In contrast to the credit institutions, the Bundesbank accumulated a large net external asset stock especially vis-à-vis foreign central banks. This includes the considerable balances maintained within the payment system TARGET as well as new claims by the Bundesbank on the ECB, which were incurred *inter alia* through the transfer of monetary reserves amounting to just over € 12 billion at the beginning of this year. Such changes in the external position of the Bundesbank, which do not count as monetary reserves, are now booked under credit transactions; in the period under review they rose by € 29½ billion. By contrast, the monetary reserves themselves were shown as a separate subitem in the balance of payments. This posting resulted in a transaction-based decline of € 13½ billion, primarily on account of the aforementioned transfer of reserves to the ECB.[5]

Moreover, towards the end of the first quarter, the monetary reserves were revalued in accordance with existing Eurosystem regulations. Particularly as a result of the rise in the value of dollar reserves, this periodic adjustment led to an increase of over € 5 billion. Net German monetary reserves – excluding euro-denominated claims on the ECB arising from the transfer of reserves at the beginning of the year – amounted to € 86 billion at the end of April. The monetary reserves of the Eurosystem as a whole were valued at € 346 billion on that reporting date compared with € 330 billion at the beginning of this year. The increase is attributable solely to the revaluation that took place towards the end of the first quarter.

**5** The transfer of monetary reserves involved a net exchange of assets, which did not alter the total net external position of the Bundesbank.