# Businesses are saving more than they are investing – hampering any rapid correction of Germany's current account imbalance

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In the current boom, Germany's enterprises have been investing significantly less in their real capital stock than they have generated in financial resources – unlike in the past. Their growing financial surplus is a key driver of the very high current account surplus for which Germany is facing broad international criticism. When exploring ways in which the current account imbalance might be corrected, it is worthwhile taking a closer look at the decisions businesses make on savings and investment. The high level of accumulated financial assets has now become a substantial obstacle to a rapid reduction of the current surplus because growing property income is feeding it. The recent strong wage increases, in turn, provide a welcome counterweight. At the same time, crucial developments, such as the ongoing decline in the payout quota and weak investment in capacity expansion in particular, point to persistent, substantial uncertainty as a significant factor that determines corporate decisions. The aim of economic policy should therefore be to finally create more certainty again as a basis for corporate decisions. Strengthening Europe and the currency union on a sustainable basis is the key to this.

### The current account surplus is high ...

At the start of the currency union Germany's current account was almost balanced but in 2017 it generated a surplus of nearly 8 % of GDP, exceeding the indicative upper threshold of 6 % agreed under the EU's Macroeconomic Imbalance Procedure for the seventh consecutive year. Its EUR 258 billion surplus is the world's highest in absolute terms. Germany is therefore facing a long row of international critics, ranging from the European Commission to the International Monetary Fund to the US president. Trump has even accused Germany of enriching itself at the expense of the US. This purely mercantilistic view – although incorrect when assessed objectively – has given rise to the increasingly concrete threat of punitive tariffs on top German export items such as cars, which is economically dangerous. The reason is that limiting exports by force through tariff policies would cause substantial damage to a key factor of Germany's success. This prospect alone makes it imperative to find ways of lowering the surplus again to a sustainable level within a reasonable period of time. A look at how the current account surplus is financed will provide a new perspective.

The surplus is merely the portion of aggregate economic savings that is not invested in domestic real capital stock, or in short: the net lending / net borrowing balance of the national economy. The net lending / net borrowing balances of the individual domestic sectors usually offset each other, at least in part. Typically, private households are net savers (net lenders), that is their savings (own funds) are higher than their investments (capital formation). Consequently, they have a financial surplus which they make available to other sectors directly or indirectly via the finance industry. General government and enterprises, on the other hand, are net investors (net borrowers) – at least in the standard economic textbook – which supplement their own funds at least in part with the financial surplus of private households to offset their financing deficit and thereby fully finance their investments with own funds and borrowed funds.

### ... because in Germany everyone is saving now

This idealised picture of the theory is no longer an accurate description of reality. Since the turn of the millennium, the government and enterprises have also become net savers. But when no domestic sector wants to assume a deficit position any longer, on balance the only way to invest surplus savings is to take them abroad. This gives rise to a growing current account surplus. While government surpluses are politically desired (referred to as 'the black zero' in Germany) and hence quite easily explainable, the enterprises' changing sides carries a much heavier weight in the growth of the current account surplus.[1]

**Table: Enterprises' net lending / net borrowing**

| Percentage of GVA | 1997–2001 | 2013–2017 | Δ |
|---|---|---|---|
| Gross value added | 100.0 | 100.0 | / |
| +Property income | 0.6 | 5.3 | 4.7 |
| -Compensation of employees | -61.4 | -59.1 | 2.3 |
| -Payouts | -20.4 | -18.7 | 1.7 |
| -Taxes and other | -0.6 | -2.9 | -2.3 |
| =Own funds | 18.2 | 24.6 | 6.4 |
| -Gross capital formation | -23.5 | -19.2 | 4.3 |
| **=Net lending(+) / net borrowing(-)** | -5.3 | 5.4 | 10.7 |

Sources: KfW Research, Destatis

### Enterprises are changing sides

A look at what drives enterprises is particularly worthwhile. The table above provides a slightly simplified picture of the basic context:[2] Businesses generate income from their real economic activity (gross value added) and financial transactions (property income[3]). They distribute this income among their workers (compensation of employees), shareholders (corporate payouts[4]) and the government (taxes and other[5]). What remains are the own funds available to finance their investments. If their investments exceed their own funds – as was still the case in the five-year upswing phase around the start of the currency union – they have a funding deficit which the corporate sector must balance with the surpluses of other sectors. On average for the years 1997 to 2001, the deficit was 5.3 % of gross value added. In the current upswing phase (specifically, in the five years from 2013 to 2017), that deficit turned into a surplus of 5.4 %, a substantial 10.7 percentage-point variation.

**Investment weakness is not the only driver**

As can be seen from the right column in the table (headed by the delta symbol for the absolute variation of the figures between the two periods), the often deplored corporate investment weakness is a significant driver of this very strong increase, with 4.3 percentage points, but not the only one. The consolidated contribution of the growth in enterprises' own funds is even greater at 6.4 percentage points.

**Growing financial assets become self-sustaining**

This is partly due to the strong increase in property income, which contributed 4.7 percentage points. Behind this position, which is defined here as a net value, is a nearly equal decrease in property income paid as a result of the long-standing interest rate decline and lower external debt (contribution: 2.5 percentage points) and a clear increase in property income received (contribution: 2.2 percentage points). The income from direct investment reinvested abroad plays an important role here. In accordance with the domestic concept of national accounts, the strong increase in German direct investment abroad during the period under review is not counted as real capital but as financial assets of domestic enterprises. Seen in isolation, the income thus generated and left abroad contributes 1.6 percentage points to the increase in enterprises' net lending / net borrowing balance. Growing inflows of funds from abroad, particularly dividends and similar payments, are likely to dominate among remaining property income received as well.[6] The financial surplus has thus acquired a growing tendency to sustain itself because the surpluses accumulated in the past feed the current surplus in the form of rising property income.

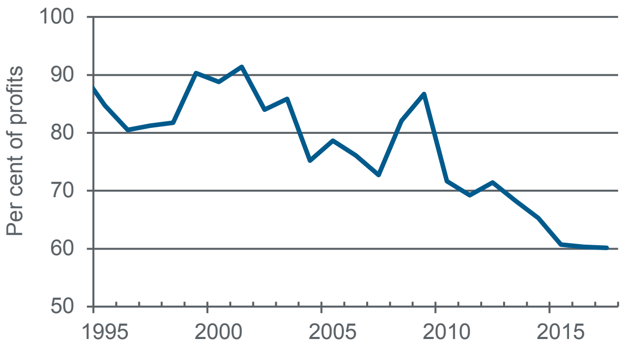
**Wage restraint has pushed profit share higher ...**

Another important factor that has driven the growth in own funds and the financial surplus in the corporate sector is the declining wage share (compensation of employees as a percentage of businesses' gross value added), which formed particularly in the long phase of pronounced wage restraint after the turn of the millennium until about 2007 (contribution: 2.3 percentage points). As a mirror opposite, enterprises' profit share grew noticeably during the period under review.

**... while corporate payouts have fallen**

However, companies are paying out less and less of their growing profits to their shareholders and are instead focusing on strengthening their internal financing capacities and their equity base. While some 90 % of corporate profits[7] were still being paid out at the start of the currency union, the payout ratio dropped to a new low of 60 % in 2017. The fall has been particularly sharp since 2010 (Figure 1). The changed payout behaviour contributed 1.7 percentage points on balance to the increase in businesses' net lending / net borrowing position. It has also impacted on private household consumption. Without the declining corporate payouts and their dampening effect on disposable income as a major determinant of private consumption decisions, the dynamic of private consumption in Germany (which has recently been quite solid after all) could probably be more vigorous.[8]

**Figure 1: Corporate payouts**




Sources: KfW Research, Destatis

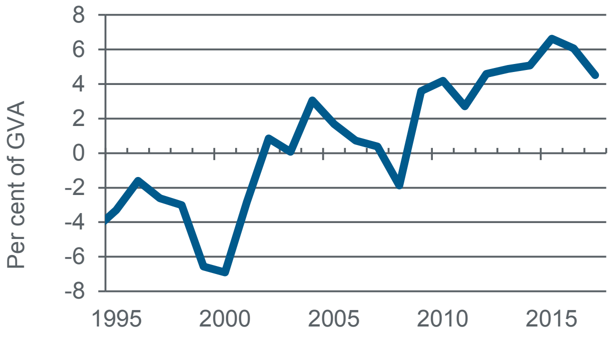
**Taxes have been the only dampener**

In the period under review, enterprises' financial surplus has been dampened only by taxes, levies and contributions to the government, which have been growing strongly in the course of the current vigorous upswing (contribution: -2.3 percentage points). On the other hand, the strong government revenues have themselves generated consistently growing public surpluses since 2014 already (2017: 1.0 % of GDP), so that the current account balance – the sum of net lending / net borrowing of all domestic sectors – changes only little as a result of this alone, at least in relation to economic output.

**First steps to reducing the imbalance**

Irrespective of this, however, first steps to reducing the imbalance can now be identified. The financial surplus of enterprises reached its maximum in 2015, at 6.6 % of gross value added, and decreased since then to 4.5 % in 2017 (Figure 2). Almost all components have contributed to this, if for different lengths of time. The drop in the wage share was a major driver of the surplus particularly before the outbreak of the global financial and economic crisis in 2008/2009. In the long upswing since 2010, with falling unemployment and rising wage levels, the development has in part reversed. Businesses' gross capital formation has slightly recovered of late (2017: 19.5 %), without of course matching the levels of preceding upturns when the investment ratio was regularly around three percentage points higher.

**Figure 2: Enterprises' net lending(+) / net borrowing(-)**




Note: Net lending / net borrowing as a percentage of enterprises' gross value added (GVA) is adjusted for two significant special effects in the years 1995 (inclusion of the Treuhand debt into the general government budget) and 2000 (acquisition of UMTS licences from the state).

Sources: KfW Research, Destatis

One important exception remains, however: To date, the trend of declining payouts to shareholders has continued unabated. It may be driven by companies' desire to become more independent from external financing by banks or financial markets – in response to the financial crisis. The preferential tax treatment of company assets may also play a role, particularly for family-owned enterprises concerned about inheritance tax. More and more of these companies will have to deal with succession in the coming years. Finally, the declining payout share may also be a reflection of the current low-interest environment, since alternative forms of investment in the financial market are not very attractive for business owners at this time. But the latter, at least, should change soon with the interest rate reversal that has begun.

## Conclusion: create more certainty and strengthen Europe

All in all, the analysis demonstrates that the causes of enterprises' growing financial surplus since the turn of the millennium – and hence an important driver of what has become a very high German current account surplus – are diverse and go beyond weak investment activity alone. Enterprises are also building up growing resources of their own through various channels. The now accumulated financial assets, in particular, have generated continuing net growth in property income, thereby feeding a growing trend to self-sustenance. This self-reinforcing effect constitutes a substantial obstacle to the rapid reduction of the surplus. The wage growth of the past years, on the other hand, is macro-economically sound and providing a welcome counterweight. Given the growing skills shortages in the labour market, wage growth can be expected to continue growing as long as the current upswing stays strong. At the same time, many developments signal ongoing significant uncertainty as an important determinant of enterprises' decisions to save or invest. The still declining payout ratio, as well as the composition of investments, are indicative of this. Specifically enterprises' investments in machinery, equipment and commercial buildings – capital goods that are quite closely linked to the motive of expansion – have seen particularly weak development. This 'defensive' fundamental attitude is generally understandable because the chain of major uncertainties and almost incalculable risks has become longer and longer in the period under review. It ranges from initially difficult access to credit after the bursting of the dot-com bubble at the beginning of the past decade, through the global financial and economic crisis of 2008 and 2009 and the euro crisis of 2011 and 2012 to Brexit, protectionism and populism in recent times. The most important aim of economic policy should therefore be to finally create more certainty again as a basis for corporate decisions. Strengthening Europe and the currency union on a sustainable basis is the key to this. ■



[1] See Borger, K., **Current account balance: reduce surplus, make Germany stronger**, Focus on Economics No. 178, KfW Research.

[2] The indicators are calculated on the basis of: Destatis, Volkswirtschaftliche Gesamtrechnungen, Inlandsproduktberechnungen, Detaillierte Jahresergebnisse (*National accounts, domestic product, detailed annual results*– our title translation), Fachserie 18, Reihe 1.4, published on 4 September 2018 (in German only). In this publication, enterprises and firms are conceptually equal to the non-financial corporations sector of national accounts.

[3] Defined here as a net figure: property income received (including profits reinvested from the rest of the world) less property income paid (without payouts and withdrawals).

[4] Including withdrawals.

[5] Defined here as a net value: net taxes on production plus the sum total of the balances of current taxes on income and wealth paid and received, net social contributions, social benefits other than social transfers in kind and other current transfers. Added to this position as a residual value are the largely negligible net effects from variations in capital transfers, acquisitions less disposals of non-financial non-produced assets, adjustments for the change in the net equity of households in pension funds and income reinvested to the rest of the world.

[6] The flows of funds generated by the cross-holdings within the German corporate sector mutually offset each other in a consolidated macro-assessment.

[7] Corporate profits are defined as gross value added plus property income less depreciations, compensation of employees and net taxes on production.

[8] See International Monetary Fund, Germany, Staff Report for the 2018 Article IV Consultation, 15 June 2018, p. 8. An indirect confirmation can also be found in Behringer, J. and van Treek, T., Income Distribution and the Current Account, in Journal of International Economics, Volume 114 (September 2018), pp. 238–254.