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Strong exports are good for Germany, excessive current account surpluses are not

Author: Dr Jörg Zeuner, phone +49 (0) 69 7431-2931, research@kfw.de

The high export ratio serves to underline the competitiveness of German exporters. Unlike other countries, they are successful without unfair intervention in the market. This competitiveness must be maintained. Economic policy should not apply the brakes to export growth. Demands of this kind should be rejected.

The current debate is not about the high export ratio but about the high German current account surplus. It is a mirror of the relative weakness of the domestic economy.

Consumption is not primarily to blame. Although the wage restraint of the last decades has resulted in a lower consumption share in the gross domestic product (GDP), at the same time, it has also led to significantly lower unemployment rates. It has also helped to correct the overvaluation of the D-Mark at the time of introduction of the euro.

Above all, the current account surplus reveals the weakness of German investment activity. An increase in public and private investments coupled with consistent attempts to combat the euro crisis is therefore the correct response to the foreign trade imbalance. Such a correction could be achieved without a deterioration in the real exchange rate. This is the only sensible starting point for politicians as wage rates in Germany are set by autonomous collective bargaining agreements. In order to bring the euro crisis to an end, we urgently need increased participation of the other large countries in the eurozone.

At 7 % of GDP, the German current account surplus is currently the highest worldwide – only some exporters of primary commodities and two smaller industrialised countries (Switzerland, the Netherlands) had an even higher surplus in 2012. Little will have changed by the end of this year. Since 2006, the annual trade balances have been exceeding the EU benchmark defined in the macroeconomic imbalance procedure (6 % of GDP).

This was not always the case. The surplus years of the 1980s were followed by the deficit years of the 1990s. The last time the German current account was balanced was in 2001. Since then the surplus has continued to grow almost every year (figure 1).

EU legal action possible

The criticism from the USA of the German current account surplus is exaggerated for various reasons. In any case, Brussel's position is a more serious matter for Germany. The EU Commission is due to present its report on national macroeconomic imbalances in the next few days. As a result, economic policy demands could be imposed on Germany to reduce its current account surplus, and delay in compliance could result in sanctions.

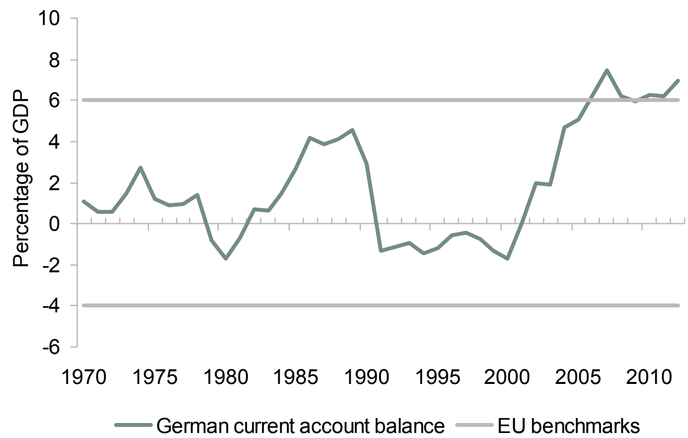
A closer look at the intra-European trade flows, however, shows that adjustment within the eurozone is already in progress. This should be of more interest to the EU Commission than European and German trades surpluses with the rest of the world. The European current account surplus with the rest of the world – at less than 2 % of European GDP – is not a potential culprit for an imbalance.

Germany plays by the rules

Exports should not be the issue. High export ratios are a sign of competitiveness and productivity. Participation in world trade has brought many economies sustainable growth and prosperity – starting with Japan in the last century, through to China in the present. This was and is beneficial for all.

High current account surpluses have not become an international economic issue in the last decade because of high export shares in GDP. They have become an issue because they, along with the current account deficits that mirror them,

Figure 1: Excessive surpluses are relatively new



Source: Statistisches Bundesamt, IMF

Figure 2: No low price strategy with exchange rate

Source: Deutsche Bundesbank

heralded the global financial crisis. A major cause of global imbalances was the active protection of their export sectors by countries such as China:

(1) The currency was and is actively managed, usually with the objective of preventing appreciation.

(2) Import barriers protect the often relatively inefficient domestic sectors from foreign competition.

(3) High subsidies for export industries make it possible to gain world market shares and crowd out foreign suppliers.

No use is made of such measures in Germany. The manufacturing industry in particular, but also many service sectors, are exposed to international competition; the international movement of capital is unrestricted, the euro is freely convertible and the exchange rate is set on the open market. The surplus in the German current account is therefore the result of decisions of private economic entities and not the result of deliberate state interventions.

Correspondingly, Germany has not established any price-related competitive advantages against its trading partners in the years in which the current account surplus built up (figure 2). Germany is part of the European single market and has traditionally been a proponent of open borders for goods, capital and – to a large extent – for services as well. Thus, the burden of adjustment does not have to be borne by the German export sector.

Strong exports, weak domestic demand

Germany should maintain its export strength and, at the same time, raise domestic demand. The result will be increased overall growth and a falling current account surplus.

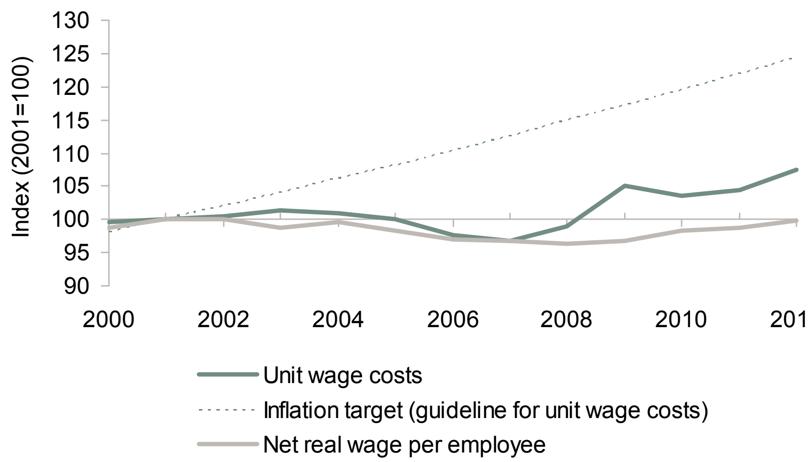
The demand for German exports is large. Export volumes have grown since 2001 by a total of 89 %. As a result, the export ratio increased by 17 percentage points to 52 % of GDP in 2012. Wage restraint in the last decade has certainly helped companies to limit the increase in export prices in the same period to only 6 %. However, the increased demand for the products of German exporters is the main reason for the increase. In any event, Germany should continue aiming for high export growth rates.

The steady rise of the current account balance since 2001 can primarily be traced back to the weakness of domestic demand. In comparison to 2001, consumption fell by four percentage points of GDP and gross investments fell by three percentage points. As a result, the import ratio increased by only 13 percentage points to 46 % of the GDP (including semi-finished goods intended for re-export). This is the result of constant real wages (figure 3), the end of high investment ratios during the modernisation of East Germany in the 1990s (figure 4) and the high risk aversion of many German entrepreneurs, reflected in the falling corporate investments and increasing equity ratios of up to 30 % in large privately owned companies. These points should be tackled, also in the interest of Germany.

Europe as a whole faces challenges

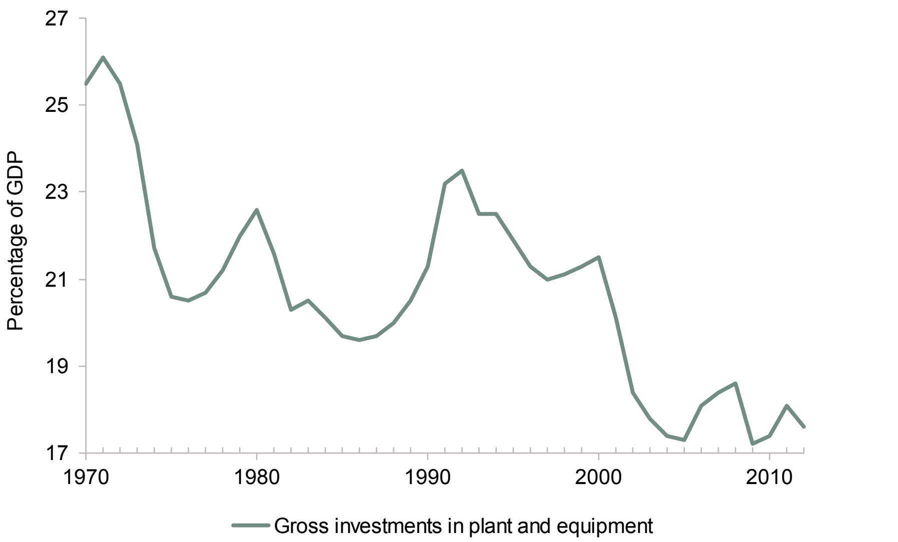
Moreover, the exceeding of the critical 6 % of GDP mark in the last two to three years is a consequence of the crisis. The savings ratio of Germans remains at a very high level. The correct response to this is sustained and resolute crisis management. Germany can make a contribution here – for example, in the form of resolute implementation of the banking union, avoiding more austerity policies

Figure 3: Real wages are constant, unit wage costs are increasing only moderately



Source: Statistisches Bundesamt

Figure 4: Macroeconomic investment ratio in nose dive



Source: Statistisches Bundesamt

and allowing more time to re-establish debt sustainability to support economic growth. The European partners must do at least as much in these areas. In France and Italy in particular, there is no way around extensive and fundamental structural reforms to the labour market, the pension system and the legal system.

More investment

According to the European Commission's autumn forecast, although the German current account surplus will fall to 6.5 % of GDP in 2015, it will still exceed the EU benchmark. This means that Germany's current account balance will remain under close observation of the Commission in the coming years. In other words, the pressure to act remains – and should be exploited for Germany's benefit.

The first priority here is investment. When it comes to increasing investment, the state is the first in line. Its gross investments have been lower than depreciation since 2003; the public capital stock is wearing out. In the medium term, an increase of the public investment ratio from the present 1.5 % of GDP to 3 % is desirable. This would reduce the current account surplus, directly increase growth and, in the medium-term, also the productivity. The financial room for manoeuvre is available, without violating the debt brake.

In order to maintain the growth potential in the long-term, corporate investment activity in Germany must be radically revived: corporate investment is set to fall to an historic low (10 % of GDP) this year. Politicians can also support this process by maintaining the excellent reputation of Germany as a business location and by reducing uncertainty in companies.

Consumption is also likely to contribute next year to reducing Germany's external imbalance, because wage growth finally accelerated somewhat.

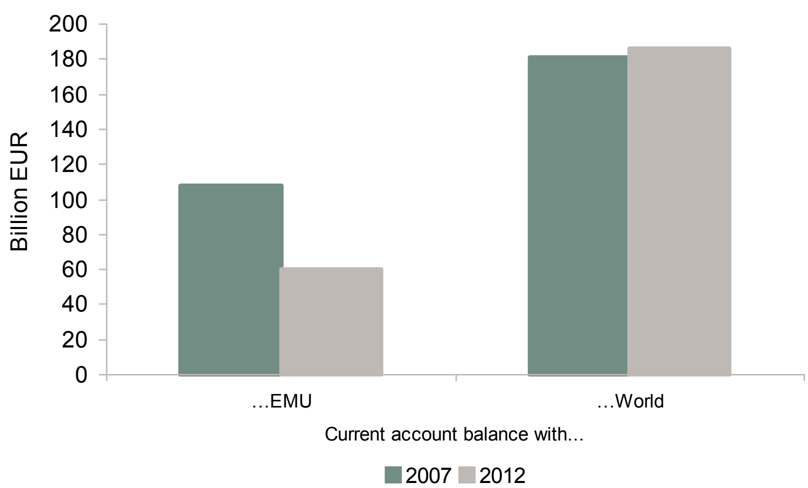
Surpluses also bring risks

A country with a high current account surplus produces considerably more goods and services than its population uses. Germany receives foreign financial assets in return for the sale of this surplus. A current account surplus is inseparably associated with capital outflows. Germany's nominal capital exports are enormous: In 2012, Germany was the worldwide number one in capital exports, ahead of China, Saudi Arabia and Kuwait. Moreover, as the current account surplus is "chronic", Germany's net foreign assets have increased strongly since 1999. Back then they were just EUR 90 billion (5% of the GDP), now they are over EUR 1,200 billion (45 % of the GDP).

Foreign assets on this scale represent a considerable risk for Germany: It is true that high savings, to a certain extent, are reasonable for a mature and ageing economy. In this way, an ageing Germany can benefit from the higher capital returns in fast growing developing and emerging economies.

However, this will only work if the international financial markets channel the savings into investment projects with sustainable profits at an acceptable risk. As experience since 2007 shows, this is frequently not the case and write-downs are the consequence. From this point of view, it is desirable to direct more German savings into domestic projects. It would also serve to counter the imbalance in foreign trade. The experience of the 1990s shows just how effective this

Figure 5: Adjustment within EMU is in progress



Source: Deutsche Bundesbank

can be, when the German current account balance even slipped into deficit due to investments in modernisation.

Germany slows down euroarea rebalancing less than apparent

The claim that Germany's constant current account surplus is preventing the economic recovery of the currency union is increasingly losing support. Within the currency union, the imbalances are already discernibly being reduced (figure 5). Thus Germany's current account surplus with the currency union has already fallen from EUR 108 billion (2007) to EUR 60 billion (2012). At the same time, German unit wage costs are increasing so that goods and services from the reform countries are becoming more attractive in terms of price. From the European perspective, therefore, the trend is healthier than from the American viewpoint.

Germany could also provide urgently needed growth stimulus in the reform countries by opening further service sectors.

Conclusion

Exports are one of Germany's strengths, exporting companies are more innovative – which generates increased productivity and ultimately more growth. We urgently need higher productivity to maintain our prosperity in the future in spite of demographic headwinds. We will then also import more. For this reason, cutting exports cannot be a solution – on the contrary, we can and should be glad about our dynamic export performance. *It* is an expression of our competitiveness.

This does not however apply to the high current account surplus – which is all too often overlooked in the economic debate. This is an expression of meager consumption and low investment.

The best way to reduce the current account deficit is therefore not to attempt to artificially choke off exports but to revive domestic demand, in particular by strengthening investment. This will not happen overnight – it will be a long road. ■