Federal Ministry
for Economic Affairs
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The German current account in the context of US-German trade

Summary

Germany is among the most important trade and investment partners for the US. Ten percent of all foreign direct investment into the US can be attributed to German firms. German companies employ around 674,000 people in the US. US companies benefit from high-quality German capital goods and intermediates that help to improve their efficiency and allow them to maintain and increase their competitiveness.[1] This creates and sustainably secures a large number of jobs in both countries.

Germany and the European Union are strongly committed to open markets across the world and to fair international competition. These are things that benefit everyone. As a member of the European Union, Germany does not pursue independent trade policy: Trade policy falls within the competency of the EU. The German government's policy is in line with all international trade agreements and treaties; in particular, German policy complies with WTO requirements.

Germany is a member of the European Monetary Union. On a global scale, the euro area balance is the only valid reference for assessing the significance of current account developments. The normalisation of monetary policy in response to the economic recovery in euro area countries will help reduce the German current account surplus due to exchange rate effects.

The German current account surplus peaked at 8.9 percent of GDP in 2015. It subsequently narrowed to 8.0 percent in 2017. The German government expects this trend to continue, not least as a result of demographic effects (declining potential workforce, falling propensity to save). Germany's current account surplus vis-à-vis the US has fallen significantly from 2.1 percent relative to GDP in 2015 to 1.6 percent in 2017.

Fiscal and economic policy in Germany aims at strengthening domestic growth and creating favourable conditions for a competitive economy. Overall, this policy helps to limit the German current account surplus. Given the record level of employment and marked increases in real wages, domestic demand has been the main driver of German growth for several years now. The German government has taken a range of measures in recent years to further strengthen an already robust domestic demand, for example by improving conditions for private investment, expanding public investment, introducing a statutory minimum wage and offering income tax relief. The conditions for a reduction of the German current account surplus are thus in place. The government plans to take further measures in the current legislative term in order to strengthen domestic drivers of growth. These include investing in infrastructure and education, reducing taxes and social security contributions for employees and families, and promoting start-ups and innovations.

However, the German current account surplus is mainly the result of market-based supply and demand decisions by companies and private consumers on global markets. The German surplus reflects a comprehensive range of eco-

1 This paper refers to data published by the US Bureau of Economic Analysis. Data from the German Bundesbank might deviate somewhat due to different conceptual approaches of data collection. Bundesbank data are available online at: https://www.bundesbank.de/Navigation/DE/Publikationen/Statistiken/Statistische_Sonderveroeffentlichungen/Statso_10/statistische_sonderveroeffentlichungen_10.html

nomic activities of private households and companies arising from international integration of production, trade and services. Hence, the surplus depends not solely on economic developments and policies in Germany, but particularly on the competitiveness and economic performance of other countries. To a large extent, the German current account is driven by factors which German fiscal and economic policy have no direct influence on, such as temporary factors including the euro exchange rate or global commodity and energy prices. In addition, the German current account balance is also shaped by a range of structural long-term factors such as demographic trends, the competitiveness of German suppliers on the global markets, an advantageous goods structure, and its high net foreign asset position.

Trade with Germany benefits the US

- **Germany is one of the most important trading and investment partners for the US.** In 2017, Germany was the US's fifth largest trading partner, and the third most important partner outside of NAFTA, with US-German trade totalling $172bn. Germany exported goods worth $118bn to the US and imported goods worth $54bn. German-American trade is driven mainly by motor vehicles, machines and other industrial products such as chemicals, pharmaceuticals, and electronics. More than half (55 percent) of German exports to the US consisted of capital goods and intermediates. The equivalent figure for US exports to Germany is around 48 percent. US-German trade in the service sector (including tourism) is also burgeoning, totalling nearly $66bn in 2017. The American market is the most important market for German exports; roughly a tenth of German exports are sold to the US.

- **The German current account surplus reflects investments made in the US.** The current account balance mirrors international capital movements. Germany's current account surplus is counterbalanced by net capital exports. In 2017, Germany invested more than $109bn in capital in the US. Of those $109bn, German investors put $37bn into US shares and additionally made direct investments worth almost $12bn. Portfolio investments in the US by German investors are primarily determined by risk-return considerations and an effort to diversify risk. The US is particularly attractive for foreign portfolio investments because of its economic and political importance for the global economy and because the US dollar is the international reserve currency. German portfolio investments in the US strengthen American capital markets, make it easier for companies to access equity and thus increase investments, which in turn boosts productivity. At the same time, German portfolio investments increase share values and thus raise the wealth of US investors.

- **Germany is the fourth largest foreign direct investor in the US.** In total, German companies have invested approximately $373bn in the US (2016), and thus account for nearly 10 percent of all foreign direct investments in the US. At $146bn, or 40 percent, the greatest share of German direct investments went into the manufacturing sector, which breaks down into investments worth $45bn in the automotive industry, 34bn dollars in the machinery sector and $32bn in the chemicals sector. At $51bn, or 14 percent, the second largest share of German direct investments went into the finance and insurance sector. Foreign direct investment by German companies in the US has increased five-fold since 1997, with an average annual rise of 9 percent. Foreign direct investments promote the international transfer of technology and knowledge and contribute to diversifying production structures. In addition, various studies show that these investments generate stronger growth in the host country than domestic investments do.

- **German investors are among the biggest foreign employers in the US.** German investors hold direct investments in over 5,300 companies in the US that generate a total annual turnover of $466bn and employ approximately 674,000 people, mostly in the automotive, machinery and the chemical industries. German affiliates in the US pay above-average salaries and contribute substantially to training skilled workers in the US.

- **Imports from Germany are important intermediates for US consumer and capital goods as well as exports.** The analysis of value-added shares shows that Germany is the US's most important European supplier of intermediates used for consumer goods, exports and gross fixed investments; overall, Germany is ranking fifth and sixth among the most important suppliers for consumer goods, exports and gross fixed investments for the US, respectively. Germany's contribution to the value chain is above-average for the manufacturing sector, especially the automotive and electronics industry, and for the machinery and plant building sector. Producers of capital goods in particular are highly specialised and provide goods for which it is very difficult to find substitutes. US companies benefit from these intermediates, as they help to improve efficiency and allow them to maintain and strengthen their competitiveness.

Germany is part of a monetary union and does not use protectionist instruments

- **Within a monetary union, it is not possible to single out any one country.** Rather, each country must be considered as a part of the monetary area as a whole. On a global scale, the only valid reference for assessing the significance of current account developments is the euro area balance. Furthermore, the value of the currency of a monetary union is determined by economic conditions in the union as a whole. Neither the member states of the euro area nor the European Commission can influence the euro area's monetary policy. The euro area's monetary policy is governed independently by the ECB, which aims at maintaining price stability. The ECB has not unilaterally intervened in foreign exchange markets for more than 15 years.

- **Germany does not use any protectionist instruments.** VAT with input tax deduction in the EU, and thus in Germany, is in line with the international standard applied by nearly all OECD countries as well as the overwhelming majority of UN members. According to the principle of taxation in the country of consumption, exports are generally exempt from VAT, while imports are subject to import VAT. VAT can then be applied to the goods in the country to which they are exported. This practice is clearly in line with WTO requirements. It serves to create fair competition on the respective final consumer market, i.e. to ensure that goods imported for final consumption are treated as equal to domestically produced goods. The VAT applied is therefore independent of whether the goods sold were produced at home or abroad. Thus, VAT does not have any discriminatory effects.

- **In an open economy, surpluses and deficits in the bilateral trade balance are the rule rather than the exception.** Surpluses and deficits reflect the comparative advantages of the various economies and the attendant specialisations within global value chains. As a country with few natural resources of its own, Germany has to finance its commodity imports by exporting other goods in the long term. When conditions are normal, this form of free trade increases welfare for all countries involved.

- **The German government is closely monitoring macroeconomic developments, although the current account balance is not a policy variable.** Nevertheless, the current account surplus may indicate structural weaknesses, also for domestic investments, which may in turn justify economic policy adjustments. In addition, capital in search of potential investment can contribute to credit booms and/or asset-price bubbles in other countries. Capital flows can thus amplify imbalances, which then require more severe adjustment measures in countries with current account deficits. This is where governments have a responsibility to implement fiscal and economic policies facilitating necessary adjustments.

- **Provided the attendant capital inflows are used for investment, current account deficits need not be problematic for a country such as the US.** If capital inflows are used for investive purposes and increase the US economy's growth potential in the medium to long term, they will create the right economic conditions to reduce external liabilities in the future (which are currently at 45 percent of GDP for the US). The deficit may be problematic, however, if foreign capital inflows are primarily channelled towards consumption or unproductive investments, such as property bubbles. The US budget has been in deficit since 2002. US debt has nearly doubled from 53 percent to 108 percent of GDP since 2000. Consequently, a large share of foreign capital inflows has been – and still is – used to finance the US budget. Hence, a reduction of indebtedness would reduce the US current account deficit.

Germany's current account surplus has narrowed considerably in recent years

- **Germany's current account surplus** narrowed from 8.9 percent of GDP in 2015 to 8.0 percent of GDP in 2017. About two thirds of the previous climb – from 5.6 percent of GDP in 2008 to 6.7 percent of GDP in 2013 and finally to 8.9 percent of GDP in 2015 – can be attributed to the decline in energy and commodity prices as well as the depreciation of the euro. Germany's bilateral current account surplus with the US has also narrowed. Having reached an all-time high of $89.7bn in 2014, it subsequently shrank by approximately $26bn, reaching $63.9bn in 2017. Vis-à-vis the US, Germany's current account surplus has fallen significantly from 2.1 percent relative to GDP in 2015 to 1.6 percent in 2017.

- **The current account surplus is likely to continue to decline in the future.** Oil prices have seen a marked increase since the middle of 2017. In the short term, this can be expected to reduce Germany's current account surplus. The recent appreciation of the euro since mid-2017 may yet have a dampening impact on the current account surplus, as export demand reacts to exchange rate fluctuations with a lag.

- Demographic trends (such as the declining potential workforce and the rising number of retirees in relation to the population as a whole) are likely to reduce Germany's current account surplus in the medium term and can even be expected to result possibly in a current account deficit in the longer term. In the short term, however, current projections do not anticipate any further significant reduction of the current account surplus.

- **International partners benefit from a strong German economy.** Germany is not only the world's third largest exporter of goods, but also the third largest importer. Our trade partners benefit greatly from the strength of the German export industry, as German exports contain a large share (about 42 percent) of imported intermediates.

- **The current account surplus is a European issue, not a German one.** The euro area posted a current account surplus of 3.5 percent of GDP in 2017. According to the IMF's recent World Economic Outlook it is set to decline to approximately 3.2 percent this year. Almost all euro area member states are contributing to this surplus.

- **From a global point of view, focusing on Germany's current account balance is not particularly conclusive.** Germany is a member of the European Monetary Union. Structural reforms implemented in recent years have sustainably reduced imbalances in the euro area. On a global scale, the only valid reference for assessing the significance of current account developments is the euro area balance. California's current account balance with China is not a subject of debate, and nor should Germany's current account balance with the US be.

The German government has taken a number of measures contributing to the reduction of the current account surplus

- **The German federal government has taken further important steps to strengthen public investment.** Between 2013 and 2017, federal budget funds appropriated for investment increased by nearly 45 percent. In addition, substantial relief was provided to the *Länder* (states) and local authorities that allowed them to increasingly channel funds towards investment. Government gross fixed capital formation went up by nearly 4 percent every year between 2015 and 2017. Due to the relatively small value-added share of imported intermediates in public investment, however, this is likely to have only a limited impact on the current account.

- **The German federal government is taking steps to boost private investment.** The government's sound fiscal and economic policy is strengthening the confidence of individuals, companies and investors in the German business environment, thus boosting private consumption and investment. In addition, the federal government and the *Länder* have allocated a total of €4bn to expanding the broadband network. A total of €17bn is being provided for energy efficiency measures until 2020. Revised grid regulation has significantly improved investment conditions for the expansion of the distribution network. The first and second Bureaucracy Reduction Acts *(Bürokratieentlastungsgesetz)* cut private sector bureaucracy costs by a total of €1bn. Recent changes in tax rules for carrying forward losses will especially benefit young and innovative companies, as will the top-ups of various project funding programmes. The federal government is also looking into ways of providing tax support for research and development alongside its project funding. Overall, private investment picked up noticeably over the course of 2017.

- **Real wages in Germany have increased at an above-average rate in recent years.** The 2014 – 2016 period saw the first phase of real wage increases in the range of 2 – 2 ½ percent since German reunification. Extraordinarily positive labour market conditions, collectively agreed wage and salary rises (which, in Germany, are negotiated without the government's involvement), the introduction of a general minimum wage, and low inflation rates have all contributed to a considerable increase in private consumption. Real wages continued to rise in 2017, despite the normalisation of consumer price inflation. This trend is poised to continue, further reducing the current account surplus. The German federal government launches numerous measures to promote sustainable and inclusive growth and a dynamic domestic economy. A general statutory minimum wage was introduced in 2015 and increased in 2017. In addition, the German government enacted income tax cuts totalling more than €11bn per year in the previous legislative term. The government plans to take further growth-enhancing measures in the current legislative term, including investments in infrastructure and education, reductions of taxes and social security contributions for employees and families, and support for start-ups and innovations. These measures will serve to further stimulate domestic demand, which has been the main driver of growth for several years now. In the medium term, these measures can make a contribution, albeit limited, to reducing the current account surplus.

- **Structural reforms in Germany can further boost the economy.** Examples include increasing competitiveness in parts of the services sector; improving incentives to work for secondary earners, low-wage earners, and older workers; and enhancing tax efficiency. It should be noted, however, that supply-side structural reforms and public infrastructure investments increase productivity and therefore competitiveness over the longer term, which could cause the current account surplus to rise again.

However, many factors affecting the current account surplus are beyond policy control

- **The current account is not an economic policy variable; it is the result of market-based supply and demand decisions by companies and private consumers on the global market.** The extent to which it can be influenced by policy measures is very limited. Alongside temporary factors such as commodity prices and exchange rates, it is largely a reflection of long-term structural conditions, which account for about half of Germany's current account surplus. They include the high level of competitiveness of German suppliers on the global markets; the high-quality, complex and industrial structure of German goods; demographic trends; and a high net asset position abroad. The competitiveness and performance of other countries also plays an important role.

- **Germany has built up high net foreign asset positions through foreign investment in recent years.** Capital exports are a result of German companies' successful globalisation strategies. Businesses are tapping new markets and taking advantage of higher returns in economies that are experiencing dynamic growth. These foreign assets result in corresponding interest and investment income, which in itself accounts for roughly a quarter of the German current account surplus.

- **German demography is a key structural factor behind Germany's current account surplus.** In an ageing society, relatively high savings are reasonable with a view to smoothing consumption over the lifecycle. Different estimates put the demography-related share of the current account surplus somewhere between one and three percentage points. Once a greater percentage of the population has retired, as is to be expected, savings accumulated abroad will gradually be drawn down.

- **Falling unit labour costs improved price competitiveness, but have been rising significantly again since 2010.** From the mid 1990s to the late 2000s, wage restraint in Germany slowed or even lowered (unit) labour costs and improved price competitiveness compared with countries that had higher wage increases. Wage restraint was a response to (a) the high wage adjustments in the wake of Germany's reunification, (b) high levels of unemployment, and (c) the overvaluation of the German currency upon entry into monetary union. The direct effects of higher price competitiveness were, on the one hand, greater demand for German products, resulting in rising exports and employment levels, and, on the other hand, lower wages and, hence, private consumption as a result of wage restraint. In the past, these developments caused the current account surplus to increase by about 1½ to 2 percentage points. However, since 2010, unit labour costs have been rising significantly, by an average of more than 1½ percent per year.

Overview of factors explaining Germany's current account surplus

Factors (largely) beyond economic policy control		Factors that can be influenced by economic policy
Temporary factors	*Fundamental factors*	
Exchange rates	Demography	Public investment
Commodity prices	Returns on foreign investments	Conditions for private investment
Wages	Economic structure, specialisation	Structural reforms
Global business cycles	International interdependency	

Recent US fiscal and trade policy measures will not contribute to reducing global current account imbalances

- **Measures such as protective or punitive tariffs help protect specific industries, but can harm the wider economy.** Simulations indicate that the new tariffs on steel and aluminium imports adopted by the US administration raise prices, expand capacity and create jobs in the US in this particular industry sector. However, aluminium and steel are intermediate goods. This means that increasing prices hikes would negatively affect other downstream industries, such as manufacturing and manufacturing-related services including construction and trade. Rising prices for products with a high steel and aluminium content (including motor vehicles, aircraft, and ships) would ultimately damage the price competitiveness of these US goods on the global market and thus reduce export opportunities. Analyses conducted by international organisations show that a general increase in trade restrictions would noticeably slow global growth and actually exacerbate trade imbalances.

- **Expansionary US fiscal policies will increase the trade deficit in the short term.** The recently adopted US tax reform can be expected to increase the budget deficit in the short term. Rising levels of new debt in the public sector tend to be associated with higher current account deficits. According to estimates, the tax reform could raise the US's current account deficit by approximately half a percentage point of GDP. For example, the Congressional Budget Office assumes that, following the US tax reform, the US's trade deficit of 3 percent of GDP (2017) will increase by 0.4 percentage points by the end of 2019. In the short term, this trend could be slowed only by a higher propensity to save among households in expectation of higher taxes. In the medium and long term, the tax related improvements in investment conditions could expand production capacities in the US, which could then help lower the trade deficit.