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ANALYSIS

Euro supports German trade surplus

Imbalance here to stay

by Marcello Minenna in Rome

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Early estimates have been officially confirmed: the German trade surplus for the past year reached 9.2% of GDP, or around €255bn. This is the highest in the world in terms of GDP, greater even than China's, and the highest ever recorded in Germany. (China, by the way, recorded a trade deficit of $9.2bn in February, partly a result of seasonal factors.)

Germany has been continuously exporting more than it has been importing since the turn of the millennium, accumulating financial claims against the rest of the world. The trade surplus began to expand in earnest from the beginning of economic and monetary union. This is not a coincidence.

Old controversies are resurfacing. For Germans, success in international trade is a signal of a highly competitive industry and a natural consequence of an aging population that tends to save more and consume less. This was clearly stated by Jens Weidmann, president of the German Bundesbank. He was countering accusations by economists who believe that these imbalances in trade flows could damage the structure of monetary union and lower the euro area's potential growth.

According to these accusations, Germans should consume and invest today what they collect from foreign trade in order to promote European growth and support inflation. Weidmann's response was that German household and public consumption grew by an estimated 1.2% in 2016. German inflation, at 2.2% in February 2017, is already the second highest in mainstream Europe after Spain. None of these phenomena has weakened exports.

Both arguments are founded on objective data, but fail to cite the key factor determining the German trade surplus: the euro.

Compared to the old D-mark, the euro was born as a weaker currency. It could not have been otherwise since it had to 'incorporate' all other member currencies, such as the lira and peseta. The single currency has provided a structural advantage to German exports. The manufacturing industry used this to expand its influence into other European markets in the years preceding the global financial crisis.

Between 1999-2008, the German trade surplus vis-à-vis Spain tripled to €24bn from €8bn. Its foreign trade surplus with Italy has grown to more than €19bn. The growth of German exports to periphery countries was financed by 'easy' credit practices by German banks. This credit expansion ended abruptly after the financial crisis and has not recovered to previous levels.

https://www.omfif.org/analysis/commentary/2017/march/euro-supports-german-trade-surplus/

The collapse of consumption in economies on Europe's periphery has slowed German exports, but the trade surplus has kept growing. Since 2012, German enterprises have gradually shifted their attention towards non-euro area markets including China, the US and UK.

The expansion of extra-EU markets came about with help from the European Central Bank. In May 2014 Mario Draghi, ECB president, announced the launch of targeted long-term refinancing operations and quantitative easing. A sharp euro depreciation followed the planned ECB balance sheet expansion and further stimulated the German manufacturing sector, increasing the trade surplus by almost 30% in less than three years.

Wolfgang Schäuble, the German finance minister, has admitted the strict relationship between the unconventional ECB policies and the diverging dynamics of Germany's foreign accounts. He did, however, shift the responsibility of the choices to Draghi and the Bank's decision-making council.

The ECB's monetary expansion and the setting of key interest rates to zero did not benefit German savers. However, the positive influence of QE on the manufacturing sector has more than compensated for the policy's worst effects. In 2015 German trade with the UK accounted for 20.7% of the surplus and that with the US 22%. These figures stood at 15% and 18%, respectively, in 2012.

Estimates by the International Monetary Fund point to Germany's implicit exchange rate being around 20% undervalued. Both Schäuble and President Donald Trump say the currency is 'too low'. To bring the external accounts in balance, the euro should be revalued at least by this amount. This, however, would be harmful for Europe as a whole.

The most politically convenient solutions, such as higher German private and public expenditure and a boost in investment, would be hardly sufficient to restrain the trade surplus. The experience of 2016 makes this clear.

It is only by completely removing the QE stimulus that the ECB could achieve a significant exchange rate appreciation. A sharp rise in interest rates would harm high-debt countries such as Italy, where the modest increment experienced at the beginning of 2017 has already raised concerns about the sustainability of government debt. It appears probable that the German trade surplus will remain with us for some time to come.

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