

Investment and Economic Situation Analysis of Germany

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Abstract: This article starts with the Preliminary Information of German investment and economic conditions, and then studies the financial markets at all levels in Germany, as well as government-ed fiscal issues, analyzes the German economic status through foreign debt, IMF programs and various indicators, and then introduces the status of German economic reforms. And the impact of the international situation on the German economy, and then through risk analysis, the development of the German economy and investment can be obtained.

Keywords: Investment; Economic Situation; Risks analysis, Germany

1. Preliminary Information

Germany is a highly developed capitalist country. One of the four largest economies in Europe, its social security system is perfect, and its citizens have a very high standard of living. The initial value of German gross national product in 2017 was 3.26 trillion euros, a year-on-year increase of 2.2 percent, and the average per capita was 44,594 dollars. High-end manufacturing, represented by automobiles and precision machine tools, is also an important symbol of Germany. At present, Germany is the largest economy in Europe and one of the founding members of the European Union. In 2002, Germany introduced the European common currency Euro. As a member of the Eurozone (with a total population of nearly 338 million), Germany's monetary policy was developed by the European Central Bank^[1], headquartered in the European continent financial center, Frankfurt. German inflation rate has continued to rise recently, but at the same time Germany has a very low budget deficit.

2. Financial markets in Germany

The four financial markets that make up the Frankfurt International Financial Centre are the Frankfurt Monetary Market, the Frankfurt Capital Market, the Frankfurt Foreign Exchange Market, and the Frankfurt Gold Market.

Frankfurt currency market. The financial power of Frankfurt forms a huge short-term capital loan market. Its business mainly includes interbank lending, open market business, discounted bills, deposits, and short-term loans. The interbank borrowing business is mainly to borrow short-term funds. Commercial banks have a demand deposit account in the Commonwealth Bank. When a bank borrows from another bank, the lending bank informs the federal bank to transfer the loan back to the bank. This kind of business allows banks to adjust the balance of their existing federal banks at any time to maintain the bank's liquidity. The commercial bank in Frankfurt is a comprehensive bank that operates a variety of banking businesses, absorbing both current and long-term deposits as well as short-term loans. Frankfurt Capital Markets. During the operation, long-term borrowing funds mainly based on Frankfurt's commercial banks and the Frankfurt Stock Exchange. In addition to issuing long-term loans, commercial banks also operate businesses that issue and trade securities, many of which are members of the Frankfurt Stock Exchange. The settlement of the Frankfurt Stock Exchange is highly efficient, mainly because Frankfurt has banks that directly deal with securities trading, such as the Frankfurt Stock Exchange and the German Foreign Reserve Bank, the former engaged in the transfer, custody and interest collection of German securities. The latter is responsible for keeping foreign securities.

Frankfurt foreign exchange market. The Frankfurt Stock Exchange is one of the top five foreign exchange exchanges in Germany. Because the Federal Bank only intervenes in the Frankfurt Foreign Exchange, the foreign exchange has taken the lead in four exchanges in Berlin, Düsseldorf, Hamburg, and Munich. effect. The more developed foreign exchange market enriches the content of the Frankfurt International Financial Center. The importance of the German foreign exchange market is actually second only to London in Europe. It consists of two parts, the first part is the formal pricing market every day, and the second part is the general market. Germany's general foreign exchange business activities have thousands of banks in Germany through telegraph and telex, but only about 100 are involved in the foreign exchange market. In addition to the general requirements for the cautiousness and liquidity of banking activities, the German Federal Bank usually has a freely convertible currency regardless of the foreign exchange market, because, in the view of the German Central Bank, it is quite difficult to control market forces. Relatively speaking, the German foreign exchange market has good flexibility, can adapt to trade and technology changes and unforeseen external emergencies, thus providing strong support for the Frankfurt International Financial Center.

Frankfurt gold market. The Frankfurt gold market is the European gold market after the London gold market, the Zurich gold

market, and the Paris gold market. Due to the high value-added tax imposed by the government, the business has developed slowly.

3. Government Involvement

External debt: Germany's External Debt accounted for 143.2 % of the country's Nominal GDP in 2018, compared with the ratio of 145.0 % in the previous year. Germany's External Debt: % of Nominal GDP data is updated yearly, available from Dec 1999 to Dec 2018. The data reached an all-time high of 165.1 % in Dec 2012 and a record low of 93.5 % in Dec 1999. In the latest reports of Germany, Current Account recorded a surplus of 25.9 USD bn in Jan 2019. Foreign Direct Investment (FDI) increased by 122.8 USD mn in Aug 2018. Germany's Direct Investment Abroad expanded by 14.5 USD bn in Feb 2019. Its Foreign Portfolio Investment increased by 9.4 USD bn in Mar 2018. The country's External Debt reached 5,533,437.8 in Dec 2018. The country's Nominal GDP was reported at 1,010.3 USD bn in June 2018. ^[2]Germany's external debt is around 5.36 trillion. Germany's external debt to GDP ratio decreased in the past 4 years. Its credit rating has been improving over the years as a result of falling debt. A ripple effect of that status is that Germany has become a more attractive country for investment^[3].

IMF programs: The IMF, backed by the U.S., has pressed Germany and others with budget surpluses to cut taxes or raise spending to prop up growth. Countries with a budget surplus "should certainly make use of it and have the space to invest and to participate in the economic development and growth," IMF Managing Director Christine Lagarde said, "but not enough has been done on that front." Germany now is under pressure from IMF and also in the stable finance situation. It's a good time for Germany to take actions to boost the economic growth and it will be a very good opportunity for foreign investors to invest in Germany^[4].

Inflation targeting: The Deutsche Bundesbank is the independent central bank of the Federal Republic of Germany. In cooperation with the European Central Bank (ECB, 2019) and the other euro-area central banks – which together form the Eurosystem – the Bundesbank has been given the mandate of maintaining price stability. Both of them do not have the inflation targeting. They clarified that "in the pursuit of price stability, it aims to maintain inflation rates below, but close to, 2% over the medium term". (Deutsche Bundesbank, 2019) They have the same goal to maintain the price stability and aims at inflation rates of below, but close to, 2% over the medium term. Both The Deutsche Bundesbank and the European Central Bank are among the most independent central banks in the world so the monetary economy is also independent^[5].

State-owned business: Germany have some state-owned business, The economically most significant ones are probably Deutsche Bahn (wholly owned by the Federal Republic) and Volkswagen (minority stake by the state of Lower Saxony in Germany).

Privatization: Several state-owned business in Germany went privatized.

Foreign exchange market intervention: The foreign exchange market intervention in Germany is led by European Central Bank. There are two types of FX market intervention, Unilateral or concerted action: In the absence of any formal agreements or general guidelines, the Eurosystem may decide, where necessary, to conduct foreign exchange interventions. The Eurosystem may conduct such interventions either on its own (i.e. unilaterally) or as part of a coordinated intervention involving other central banks (i.e. concerted action).

Centralised or decentralized: Interventions may be carried out either directly by the ECB (i.e. in a centralised manner) or by NCBs acting on behalf of the ECB on a "disclosed agency" basis (i.e. in a decentralised manner). Whether the intervention is conducted in a centralised or a decentralised manner is irrelevant from the point of view of the ultimate objective of the operation. Any intervention relating to another EU currency is performed without prejudice to the ECB's primary objective of maintaining price stability and is carried out by the Eurosystem in close cooperation with the relevant non-euro area NCB, particularly with regard to the financing of the intervention^[6].

Germany's economic freedom: Germany's economic freedom score is 73.5, making its economy the 24th freest in the 2019 Index. Its overall score has decreased by 0.7 point, with declines in monetary freedom and business freedom outpacing an increase in government integrity. Germany is ranked 14th among 44 countries in the Europe region, and its overall score is above the regional and world averages. Overall, as for government involvement, Germany is a promising market to invest.

4. International situation

Germany as the member of European Union, it is influenced by the international trade environment. As one of the most important members of European Union, Intra-EU trade accounts for 59% of Germany's exports (France 8%, United Kingdom 7% and the Netherlands 7%), while outside the EU 9% go to the United States and 6% to China. In terms of imports, 66% come from EU countries (the Netherlands 13%, France 7% and Belgium 6%), while outside the EU 7% come from China and 5% from the United States. Thus, the economy's development of EU has great influence on Germany. (Anonymous, 2019) In addition, IMF helps Germany manage the balance of payments difficulties and international financial crises. The International Monetary Fund (IMF) is an international organization, consisting of 189 countries working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world. For example, IMF encouraged Germany to spend more and should do so to boost economic growth and reduce its current account surplus in 2018-2019. The fall of the Berlin Wall in 1989 influenced not only the German economy, but also the economies of countries around the world. In the lead up to the collapse of the wall, Hungary and Czechoslovakia opened their borders and allowed East Germans to take refuge in Austria. (Drew, 2014) The influx of people meant the economies of neighboring countries took a hit.

After the Berlin wall fell, both East and West Germany economies had a big change. In early days, the West was taxed heavily in a bid to raise the funds to invest in the East, while the East German currency became worthless. West Germany had to put forward 10% of their GDP to rebuild the eastern area. After the wall fell in a short term, the GDR (German Democratic Republic) which was in power in the East stopped its governance of East Germany. In this case, the GDR economy collapsed because of the change of currency. Before the reunification of the two regions, 1 West German Deutsche Mark was the equivalent of 4.50 GDR Marks. After the collapse of the GDR, the currency was set at a rate of 1 to 1^[7]. In addition, the horrible increase of the number of refugees to German in 2015 still has a big effect to German. However, it is good news for direct investors. The increase in population gives more chances for direct investors to find workers here. Since most immigrants have strong motivations to work, it is easy for employee to find good workers with low costs. However, more chances always accompany with high risks, the German government also faced big political

crisis in 2015. However, the German government has proved its stability in recent years.

5. Risks analysis

Higher taxes and lower spending in Germany have led to the budget surplus and the contraction of more public debt (59.8% of GDP in 2018, 63.9% in 2017, according to IMF). But at the end of 2018, the economy of Germany contracted due to the decrease of export, in the face of the trade tensions between US and China, and a hard Brexit. In addition, the government's fiscal policies predict less revenue, tax cuts and more government spending in 2019, which may lead to the increase in deficit or fiscal deficit. Nevertheless, the country's public debt is expected to further decrease down to 56% of GDP, below the 60% target set by the European Union. Inflation – at 1.8% in 2018 – should remain stable in 2019. However, Unemployment is expected to fall to 3.4% and 3.3% respectively in 2019 and 2020, from 3.5% in 2018 (IMF). In this case, the economic situation would attract more investments in 2019 and the uncertainty of investment is relatively low.

Political risks: When it comes to political risks, the capacity of Germany to honor its payment obligation is high, so the political risk is relatively low. However, the results of the general elections of September 2017 forced the Chancellor Angela Merkel to form a grand coalition with the Social Democrats, after a failed attempt to assemble a government with the liberal Free Democrats and left-leaning Greens. The social democrats advocate the modernization of the economy to meet the demands of globalization, but they also stress the need to address the social needs of workers and society's disadvantaged. The change of government management might release a positive signal to the foreign investors.

Because Germany has a net export, we believe that Germany's local economy is developing better. At this time, the euro will appreciate and the relative foreign currency will depreciate. From this perspective, when foreign companies complete a trade with Germany, they export to Germany. German needs to use the local currency Euro to exchange foreign currency, and then use foreign currency to make the payment; if the foreign currency depreciates in the market on the future payment date and the euro appreciates, the German party can pay with less euros. At this time, foreign companies have to bear the risk of trading.

6. Conclusion

From the information above, we know the economy of Germany kept the stable and healthy development. Historically speaking, Germany is a highly developed capitalist country while Frankfurt is a city with a long-standing financial tradition, which means the financial system has developed. In other word, German financial market has good flexibility and can adapt to big changes in the market. Most indirect investors and bankers may be attracted because of its high credit and high reliance. In addition, as Britain fell out of the EU, the status of European financial center of Frankfurt has risen. The good financial environment, the economic strength and high sovereign rate of German give Frankfurt a chance to be the biggest financial center in Europe. As the Global financial center ranking index, Frankfurt has risen from the 20th to 10th in 2018 after Britain fell out of the EU. The quick development of Frankfurt is a signal of more investing chances which may attract more investors.

High taxes, low inflation rates and low government spending are the main characters of the German government, which led to budget surplus and low external debt in the past few years. Conversely, export occupies the main component of German economy. However, because of the sharp decrease in export in 2018 and the pressure from IMF, the government decided to increase government spending to stimulate the economy, which is a signal for Germany to use expansionary fiscal policy. Since the political risks of Germany are low in the past few years, the government bonds may be good choices for foreign investors. Although the export will have a trend of decrease in the future, export is still the most important part in German economy. In other word, the German economy is very sensitive to the change of exchange rate. Since Germany keeps the fixed exchange rate policy, investors can avoid exchange rate risk. Unifying the country national condition, Germany is the most populous country and the biggest economic entity in EU with a good location. Both the living standard of people and the level of economy development take the leading position in the world. Moreover, the refugees will not be a big problem for the German society. Instead, the increase of population gives direct investors more chances to make profits in Germany. Compared to other countries in EU, German's status of leader of EU has been strengthened after Britain fell out of the EU. On one hand, ECB is set in Frankfurt, which takes responsibility of the monetary policy of EU and currency regulation of the whole Eurozone. On the other hand, the recent increase of property price in Frankfurt and offshore RMB, which increases the foreign exchange reserve in Germany, give more investment opportunities for both domestic and foreign investors. Meanwhile, the high business and investment freedom in Germany provides an ideal environment to do business.

In conclusion, Germany is a good country to invest for both direct and indirect investors. Considering the high stability and high security of the financial markets, hedgers may prefer to invest here. Also, the possible change of export and government spending in the future and the influence of Brexit give investors more chances and greater development potential.

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