Foreign capital flows into Germany

Will foreign investors continue to support a dying U.S. economy? The hands and feet are saying no.

While it is certainly no secret that international investment capital is flooding into the Federal Republic of Germany (F.R.G.), the magnitude and intensity of that flow denote a fundamental shift away from the United States as the primary repository of such funds. In short, foreign investors smell the stench of the rotting American economy, and have begun—quietly, but decisively—to get out while they can.

In the last quarter of 1989, net foreign investment in the F.R.G. is estimated by various analysts at between $20-24 billion. Most of this occurred in the last half of the quarter, with an enormous acceleration in December which has continued into 1990.

This represents an extraordinary surge. As a surplus trading nation, West Germany has traditionally invested more abroad than foreigners have put into the country. The result has been a veritable explosion in its stock markets, and swelling investment accounts at its banks. In October alone, even before the breaching of the Berlin Wall, West German stock markets saw a DM4.5 billion investment increase—DM4.2 billion of which came from abroad.

German and Japanese bankers estimate that anywhere from $5-10 billion has shifted from U.S. markets into F.R.G. investments since mid-1989. At least half of this has occurred in the last two months, meaning a net outflow from the U.S. of $1-2 billion. And this is undoubtedly accelerating.

A substantial portion of the international capital pouring into West Germany is coming directly from Japan. According to an economist at Nomura Research Institute in Tokyo, $1.89 billion in net purchases of foreign securities was made in November by investors from Japan itself—that is, not including any Japanese money based in other countries like the United States. The vast majority of this went to Germany. December saw a 50% jump, to $2.9 billion in net foreign securities purchased, and almost all of the $1 billion increase also flowed to the Federal Republic.

The December surge, largely from Tokyo institutional investors into the German markets, was triggered by Japanese individuals and small investors, who, from mid-November to mid-December, poured funds into their F.R.G. bank accounts. This positioned them for rapid participation in everything from joint venture deals to the stock markets, and both took advantage of, and helped push up, the value of the deutschemark against the yen.

In fact, there is no doubt that Japanese investment in West Germany has been steadily escalating toward the current take-off. Since February 1989, the mark has appreciated nearly 30% against the yen. It has risen from about 68 yen to the mark to about 88; and more than half of the gain has come since September.

None of this even takes into account Japanese capital flowing into Germany from investments in other countries, especially the United States. There is no question that Japanese investments in the U.S. have slowed, both in terms of direct and portfolio investment. The recent Treasury refunding saw only 20-25% Japanese participation, as compared with their past levels of 35-40%.

Recent hikes in interest rates by the Bundesbank and Bank of Japan have fueled the flow of funds away from the U.S., and have also forced nearly a 1% rise in American market rates. It is likely that both Japan and West Germany will raise rates again, and soon, despite enormous political pressure—and probably threats—from the U.S.

Perhaps the most important indicator of the intensity of the shift toward Germany and Western Europe is coming from Britain. Through the third quarter 1989—again, even before the November opening of East German borders to the West—by far the largest increase in foreign investment into West German stock markets came from the British. Through the third quarter, the British have increased their F.R.G. market investments by DM6 billion, more than the DM5.5 billion increase for all of 1988, and over DM4 billion more than money coming from the U.S. or Japan.

British capital, of course, has long been the bulwark of foreign flows into the United States. But this increased participation in Germany might herald much more than just Britain smelling some green pastures.

Early this month, Britain proposed to change its accounting rules such that British investors in corporate takeovers and leveraged buyouts no longer could enjoy certain advantages over their U.S. competitors that had heretofore made such investments both attractive and feasible. This would effectively preclude any further participation in U.S. leveraged buyouts and takeovers, into which $60 billion in British money has gone over the last two years. Thus, some $30 billion a year could potentially be redirected elsewhere—i.e., to Germany and Europe.