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The Myth of the Stupid German Investor

by Michael Heise

Germans save a lot, produce plenty and spend little. The result is a massive external surplus. Last year, Germany's current account surplus stood at almost €200 billion ($260 billion), the world's largest. The flipside of this surplus is an equally impressive transfer of capital abroad, as a result of which Germany is one of the rich world's biggest net creditors. Critics claim that much of this money is invested badly. The real problem is different from what those critics suggest.

The debate traces back to 2010, when financial journalist Michael Lewis wrote about the "stupid Germans in Düsseldorf" who would buy up any dicey financial product proffered by Wall Street bankers. Other commentators have argued that Germany's willingness to buy Greek debt or American subprime mortgages, for example, has fueled regional and global imbalances and contributed to financial crises. Meanwhile, two recent papers purport to show that the capital export is bad for Germany too, on the theory that Germans are losing money on their overseas investments.

In one study, Germany's DIW Institute for Economic Research compared Germany's accumulated external surpluses (excess savings exported and invested abroad) since before the financial crisis to its net external asset position today (the value of assets held abroad by Germans minus the value of German assets held by foreigners). It concludes that the current value of Germany's overseas assets is some €640 billion less than the amount of money Germany has sent overseas, suggesting a loss equivalent to more than 20% of last year's GDP, or €16,000 for every German household.

In another paper, the Peterson Institute for International Economics finds an even bigger shortfall in Germany' net international asset position, which it puts down to "substantial valuation losses" on Germany's external investments in the 2006-11 period.

If these analyses were correct, the implication would be that Germans are working hard to generate exports, the proceeds of which they invest in junk abroad. Such "stupidity" would prove catastrophic for an ageing country that will increasingly rely on its savings as the working-age population shrinks.

Fortunately, the truth is less dire. Germany as a whole has suffered losses during the global financial crisis and the euro crisis, as has everyone. But there is no evidence that these losses are disproportionate relative to those experienced by other global investors.

The Bundesbank recently found that the main factors behind the apparent destruction of German wealth are statistical. Almost two-thirds of the €640 billion gap DIW found is due to the different ways in which the current account (a flow concept) and the net asset position (a stock measure) are computed, as well as the dissimilar treatment of derivatives. Gains in the value of foreign investments in Germany (also due to low bond yields) explain much of the rest. Losses on the value of Germany’s external assets—what commentators mean when they talk about stupid investments—account for only 12% of the gap.

As a matter of fact, despite unfavorable global conditions, Germans have earned decent returns on their foreign assets in recent years. In the last nine years, the total return on German external financial investments averaged 4%, whereas foreigners gained 3.8% on their assets inside Germany. The gap is even more pronounced when one looks at individual asset classes, such as bonds, and at direct investments. Last year, Germany earned €75 billion on its capital account, which adds to Germany’s positive trade balance to produce its enormous current account surplus.

It’s important to put the debate about Germany’s external surplus in perspective, because lurking behind complaints about Germany’s high savings and overseas investments are serious policy challenges. Above all, critics imply that Germany should save less and consume more. But that would be short-sighted in an ageing society that still relies on an overstretched pay-as-you-go pension system. By 2030, Germany will have one of the highest ratio of elderly to working-age population in the eurozone. As public pensions fall, retirees will have to use their private savings to supplement their incomes.

Worsening demographics will not only drive Germany’s need for savings, they will also depress its medium- to long-term growth prospects. It is hard to earn decent returns on savings in a slow-growing economy. Therefore, portfolio diversification, including into higher-yielding foreign assets, is a must. The German financial sector is far from perfect. But it has shown that, on average, it can help with this diversification in an effective manner.

The real problem behind the German current-account surplus is not that savings are too high but that this supply of capital is not absorbed by investments. In the manufacturing sector, the capital stock has been on a downward trend for many years, while roads, bridges and other public infrastructure urgently require more money for renewal and expansion.

Therefore, a growing chorus of economists, politicians and commentators in Germany are calling for higher private and public investments. The government should respond – but not by fiscal pump priming. It should focus on improving the conditions for corporate investments, for example through keeping energy affordable, accelerating the depreciation of investments and making it easier for Germany’s high savings to flow into infrastructure improvements.

The Germans’ propensity to save will serve them well as they age. The debate should focus instead on how to make the investment environment in Germany more attractive. Such measures would boost the performance of the economy, improve living standards and lower Germany’s external surplus.

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