Securities markets

Debt securities market

Interest rate movements

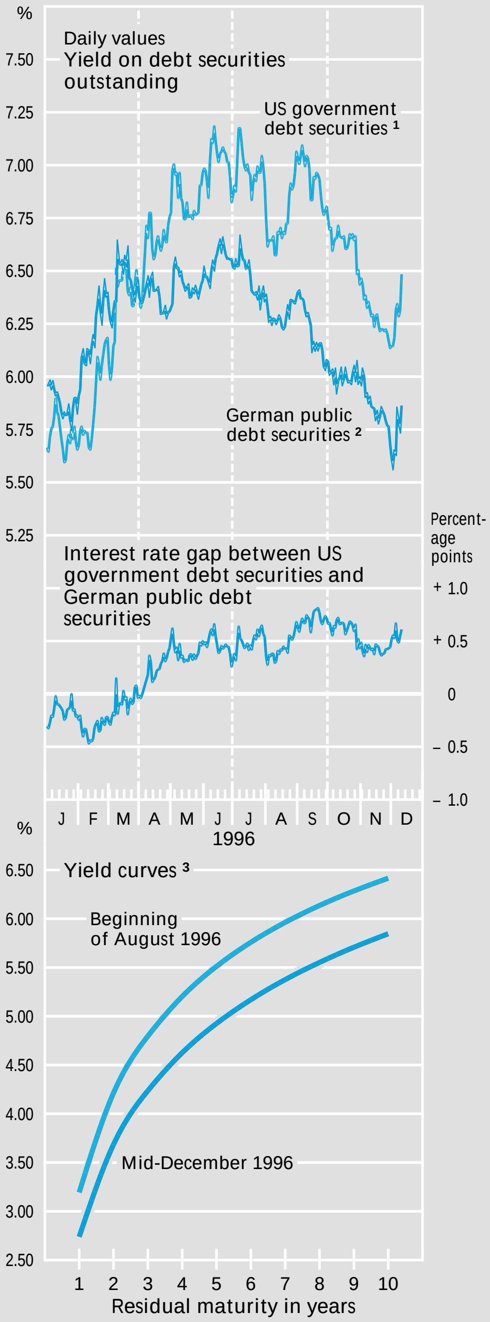
Capital market rates at a record low

German capital market rates fell to a new all-time low in the autumn months. The yield on domestic debt securities outstanding had risen to more than 6 % by the beginning of July, which subsequently led to the start of a sharp decline in interest rates that persisted – with only brief interruptions – until late autumn. At the beginning of December, capital market yields, at 5 %, were on average even a little lower than at the end of January 1996, when the yield on domestic debt securities outstanding had reached its then lowest level. Following this, capital market rates – starting with the US debt securities market – rose again slightly; in mid-December the yield on domestic debt securities outstanding came to just under 5¼ %. The yield curve in the German debt securities market flattened slightly owing to the marked decline in yields at the long end of the market; the yield curve continues to be comparatively steep at a low level, however. The yield advantage of ten-year Federal bonds over paper with a residual maturity of one year, which is discernible in the market, still came to about 2½ percentage points in mid-December.

Sustained favourable outlook on stability

In the past few months the fall in capital market rates was aided, in particular, by the favourable prospects for a continuing stable price climate. No inflationary tensions are apparent despite growing indications of a further upturn in the economy. Given that capacity utilisation in German industry is below the long-term trend and the fact that the

Interest rate movements
in the debt securities market



1 US Treasury paper; residual maturities of approx. ten years. — **2** Federal securities with residual maturities of nine up to and including ten years eligible for delivery at the DTB (German Financial Futures Exchange); unweighted average. — **3** Regression curves for listed Federal securities.

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situation in the labour market remains difficult, the scope for price and wage rises appears to be narrowly limited at present. Even the fact that monetary expansion is comparatively sharp, which is essentially a mirror image of the weakness of monetary capital formation, does not point to any risks for price stability. Foreign debt securities markets, too, generated stimuli for a downward movement of interest rates. A major part in this was played by the fact that the prospects of a long-term containment of inflation are rated as being particularly favourable in many quarters internationally. Above all, the sustained growth of the US economy with low inflation rates is often assessed as an indication that inflationary risks have diminished over the long term on account of growing competition in the goods and factor markets. However, in view of the rapid fall in yields and the high incidence of record prices, the susceptibility of the debt securities markets to disturbances has risen again of late. The yield advantage of ten-year US Treasury paper over Federal bonds with comparable maturities declined on balance by more than three-quarters of a percentage point in mid-September to less than two-thirds of a percentage point in mid-December.

Fighting inflation as a long-term objective

The sharp decline in capital market rates, which is apparent worldwide, is not least a demonstration of the fact that the commitment to the goal of price stability by a growing number of central banks represents the appropriate allocation of economic policy functions. However, it is precisely in an environment marked by low inflation rates that it remains important to perceive the containment of inflation as a permanent objective and not to allow any doubts to arise about the anti-inflationary stance of monetary policy. Given the price stability that has been achieved at present, notions of pressing the central bank once more into the service of stimulating economic activity in the short term fail to recognise the long-term nature of the task of maintaining stability. Apart from that, a short-term policy of this kind would increase the risk of speculative dislocations in the financial markets due to an overabundant supply of liquidity and the unsettling of investors.

Sales of debt securities

Amount raised

Gross sales of domestic debt securities increased perceptibly between August and October 1996. Domestic borrowers issued debt securities to the market value of DM 173.6 billion, compared with DM 147.0 billion in the three preceding months and DM 167.0 billion between August and October 1995. The amount raised by sales of domestic debt securities was only slightly higher than in the previous period, however, owing to sizeable securities maturities. After deduction of redemptions and after taking due account of changes in issuers' holdings of their own-debt securities, net sales came to DM 54.0 billion between August and October, compared with DM 52.4 billion in the previous period and DM 71.9 billion in the corresponding period of 1995. Between August and October 1996 foreign debt securities were sold in the domestic market to the tune of only DM 1.9 billion, compared with DM 6.4 billion between May and July. While debt securities denominated in foreign currencies were sold in Germany to the value of DM 2.4 billion, and thus to about the same extent as in the preceding period (DM 2.8 billion), domestic investors on balance sold foreign Deutsche Mark bonds (– DM 0.5 billion). Overall, the amount raised by sales of domestic and foreign debt securities between August and October came to DM 55.9 billion, compared with 58.8 billion in the three preceding months and DM 81.9 billion a year before.

Bank debt securities

Almost all of the funds raised by sales of domestic debt securities between August and October accrued to credit institutions (DM 50.4 billion net). At DM 35.5 billion, more than two-thirds of this amount consisted of communal bonds *(öffentliche Pfandbriefe).* These securities (which had hitherto been known as *Kommunalobligationen* in the capital market statistics of the Deutsche Bundesbank) represent debt securities issued by mortgage banks and regional giro institutions and are covered by claims on the public sector. Issuing activity was particularly brisk in this market segment in September (DM 17.0 billion), when the Länder Governments, in particular, raised borrowers' note loans with banks to a significant extent. The “traditional” mortgage bonds *(Hypothekenpfandbriefe)* (hitherto known as *Pfandbriefe* in the capital market statistics) are covered by liabilities secured by first mortgage; in the period under review their sales yielded DM 5.5 billion. Other bank debt securities, which are used mainly to refinance general longer-term lending business, were sold for DM 11.2 billion net. The outstanding amount of debt

Sales and purchases of debt securities

DM billion

Period	Sales						Memo item Balance of transactions with non-residents 3
		Domestic debt securities 1			Foreign debt securities 2		
			of which				
	Total	Total	Bank debt securities	Public debt securities	Total	of which Foreign currency bonds	
1996 May–July	58.8	52.4	35.6	16.2	6.4	2.8	+ 15.7
Aug.–Oct.	55.9	54.0	50.4	3.7	1.9	2.4	+ 19.2
Compare 1995 Aug.–Oct.	81.9	71.9	51.0	20.8	9.9	8.8	+ 5.6

Period	Purchases						
		Residents					
				Non-banks 5			
	Total	Total	Banks (incl. the Bundesbank) 4	Total	Domestic debt securities	Foreign debt securities	Non-residents 2
1996 May–July	58.8	36.7	17.2	19.4	20.3	– 0.9	22.1
Aug.–Oct.	55.9	34.8	31.8	2.9	6.4	– 3.5	21.1
Compare 1995 Aug.–Oct.	81.9	66.3	40.9	25.5	20.9	4.6	15.5

1 Net sales at market values plus/less changes in issuers' holdings of own-debt securities. — **2** Transaction values. — **3** Purchases of domestic debt securities by non-residents less sales of foreign debt securities to residents; – = capital exports, + = capital imports. — **4** Book values; statistically adjusted. — **5** Residual.

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securities in the market issued by specialised credit institutions fell by DM 1.8 billion. The main reason for this was the redemption of a debt security which had been issued at the beginning of the nineties in connection with the restructuring of the east German banking system.

Public debt securities

Between August and October the public sector drew on the debt securities market to a much smaller extent than in the preceding three months. Overall, public issuers' bonded debt rose by DM 3.7 billion in the period under review, compared with DM 16.2 billion between May and July. The slight increase in indebtedness in the securities market in the period under review does not reflect a reduced need of funds, but is for the most part ascribable to the fact that public borrowers have covered their credit requirements to a large extent through other sources, such as raising borrowers' note loans or issuing debt securities running for less than one year, which are not counted as debt securities. The Federal Government's borrowing in the debt securities market came to DM 8.3 billion, being mainly in the shorter-term maturity category. Besides the established Federal savings bonds and five-year special Federal bonds, the sales of which yielded DM 3.4 billion and DM 2.0 billion on balance, respectively, the Federal Government issued two-year Treasury notes for the first time in September. At the end of October the outstanding amount of such paper came to DM 8.9 billion. The Länder Governments received DM 3.0 billion from own-debt securities; in August a number of Länder Governments for the first time jointly issued a debt security with a volume of DM 4 billion. The notes of the Treuhand agency outstanding in the market declined by DM 3.9 billion, while debt securities of the post office and the railways were redeemed to the extent of DM 2.6 billion and DM 1.2 billion, respectively. The other public issuers' indebtedness in the debt securities market changed only marginally.

Foreign Deutsche Mark bonds

Between August and October foreign borrowers issued debt securities denominated in Deutsche Mark to the tune of DM 28.4 billion (nominal value). About one-third of this amount was accounted for by drawings in the context of medium-term note programmes; these facilities permit issuers to structure the terms of the issued securities flexibly within the agreed programme framework. In addition, several large-volume foreign Deutsche Mark bonds were issued as asset backed securities. These are specialised financing companies' debt securities, which are covered by claims (e.g. from credit card operations) that are sold to those companies, in particular, by banks. Net sales of foreign Deutsche Mark bonds came to DM 17.6 billion in the period under review, compared with DM 15.5 billion between May and July and DM 13.7 billion in the corresponding period of 1995. All securities were sold to non-residents.

Short-dated debt securities issued by the public sector …

The market for short-dated debt securities denominated in Deutsche Mark issued by non-banks was stimulated in autumn mainly by the second issue of Treasury discount paper of the Federal Government with a maturity of six months ("Bubills"), which yielded DM 8.6 billion. The outstanding amount of Bubills thus reached the limit of DM 20 billion agreed between the Federal Ministry of Finance and the Deutsche Bundesbank for 1996 and 1997. Roughly one-half of the second tranche of Bubills was sold to non-residents and to German banks, respectively. In September, debt securities running for less than one year to the value of DM 0.3 billion were launched for the first time by a Land Government, too; these were within the maximum limits of outstanding amounts set for the individual Länder Governments in line with those applying to the Federal Government.

… and by enterprises

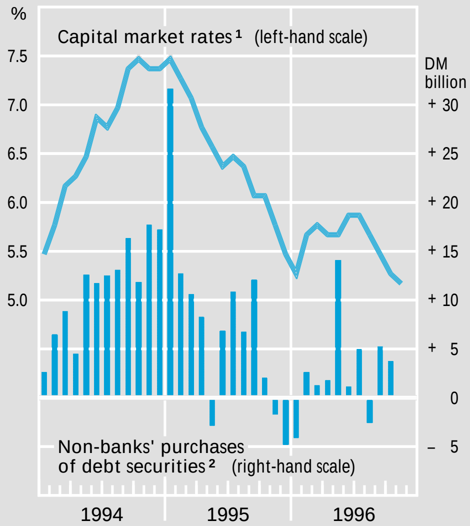
The market for Deutsche Mark commercial paper (CP), which, like Bubills, are not included in the figures analysed here, was drawn on somewhat more heavily by domestic enterprises in the period under review than in the preceding period. The outstanding amount of CP issued by residents increased by DM 1.9 billion to DM 10.2 billion. Foreign non-banks reduced their CP indebtedness in the period under review by DM 0.9 billion to DM 11.8 billion.

Purchases of debt securities

Sharp rise in the banks' debt securities holdings

Domestic credit institutions' debt securities portfolios increased by DM 31.8 billion between August and October, compared with DM 17.2 billion in the three preceding months. On balance, they consisted almost exclusively of debt securities issued by domestic banks (DM 29.0 billion). Savings banks (DM 5.5 billion) and credit cooperatives (DM 4.2 billion) have – as usual – bought a par-

Capital market rates and purchases of debt securities by non-banks



1 Yields on domestic debt securities outstanding. — 2 Net purchases or net sales of domestic debt securities by domestic non-banks.

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ticularly large number of bank debt securities. Banks sold public debt securities to the tune of DM 2.3 billion (net) in the period under review. Credit institutions purchased foreign debt securities to the value of DM 5.4 billion.

Slackening foreign demand

Foreign investors' interest in domestic debt securities tailed off between August and October. During this period non-residents invested funds to the value of DM 21.1 billion in German debt securities, which was still roughly as much as in the preceding three months, when their purchases had amounted to DM 22.1 billion; during the period under review foreign demand slackened markedly, however. Bank debt securities were to the fore, at DM 13.8 billion; about two-thirds of this amount consisted of securities denominated in foreign currency. During the period under review foreign investors on balance purchased public debt securities totalling DM 7.3 billion. The two-year Federal Treasury notes issued for the first time in September met with great interest and accounted for DM 4.8 billion of that sum alone.

Little interest in buying on the part of non-banks

Non-banks' propensity to invest in the domestic debt securities market was comparatively slight recently given low capital market rates, and probably also on account of uncertainties concerning the third stage of the monetary union. Net purchases by domestic non-banks came to only DM 2.9 billion between August and October, compared with DM 19.4 billion in the three preceding months. Non-banks' declining purchases of domestic debt securities (DM 6.4 billion, compared with DM 20.3 billion between May and July) are, first and foremost, due to purchases of public debt securities. In the period under review domestic non-banks sold such securities to the tune of DM 1.4 billion (net), after they had purchased public debt securities to the value of DM 9.0 billion between May and July. Non-banks' holdings of bank debt securities rose by DM 7.1 billion. Non-banks sold foreign debt securities worth DM 3.5 billion.

Share market

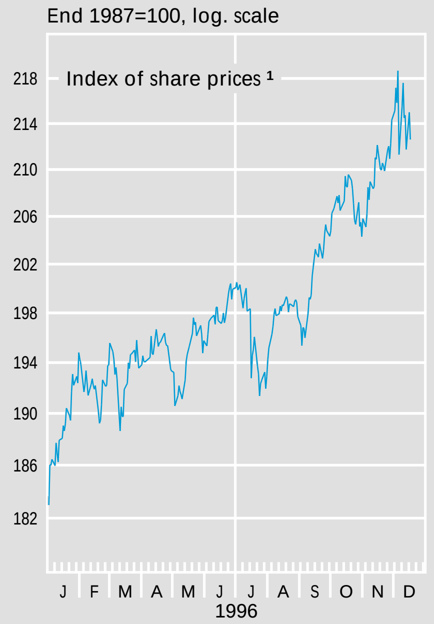
Share price trends

Prices in the German share market reached new record levels in autumn. The CDAX share price index, which includes the prices of all shares of domestic companies officiallly quoted on the Frankfurt stock exchange, went up by more than 14 % between the end of July and the beginning of December. Against the backdrop of a favourable earnings trend in the case of many enterprises, domestic equities benefited, firstly, from the internationally bullish share markets, and, secondly, from the low and still falling interest rate level. There was an above-average price increase in export-oriented sectors such as chemicals (+ 26 % between end-July and end-November) or the motor industry (+ 25 %), which benefited from the depreciation of the Deutsche Mark against major trade currencies. The pronounced propensity to invest in the German share market was shown, not least, by the fact that Deutsche Telekom's admission to stock exchange dealing in November was managed without a significant decline in the price level. In the above-mentioned fall in prices at the beginning of December, which also affected share markets worldwide, prices went down by almost 3½ %. When this Report went to press, prices were 2 % below the record level at the beginning of December.

Share sales

Issuing activity in the German share market was muted between August and October in the run-up to Telekom's listing on the stock exchange. Domestic enterprises issued new shares to the market value of only DM 2.5 billion, compared with DM 3.9 billion between May and July and DM 4.9 billion in the corresponding period of 1995. Only three issues had a market value of more than DM 100 million. Between August and October sales of foreign participatory instruments in Germany, at DM 3.5 billion (net), were on the same scale as in the preceding three months.

Price movements
in the share market



1 CDAX share price index; daily values. — Source: Deutsche Börse AG.

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As was already the case in the preceding period, this was due mainly to direct investment, whereas portfolio purchases were of lesser significance. The total amount raised by sales of domestic and foreign equities came to DM 6.0 billion between August and October, compared with DM 7.3 billion between May and July and DM 7.2 billion in the corresponding period of 1995.

Share purchases

Between August and October domestic investors predominated on the buyers' side of the German share market. Credit institutions increased their shareholdings somewhat more sharply than non-banks (by DM 2.7 billion and DM 1.7 billion, respectively). Credit institutions almost exclusively purchased domestic shares (DM 2.5 billion), while non-banks sold such paper on balance

(– DM 1.5 billion); their share purchases focused on foreign equities (DM 3.3 billion). In the period under review foreign investors purchased German shares to the tune of only DM 1.5 billion, whereas their net purchases had come to DM 15.7 billion in the preceding three months. In August and October they used the temporary strengthening of the Deutsche Mark to sell domestic equities on a small scale.

Investment funds

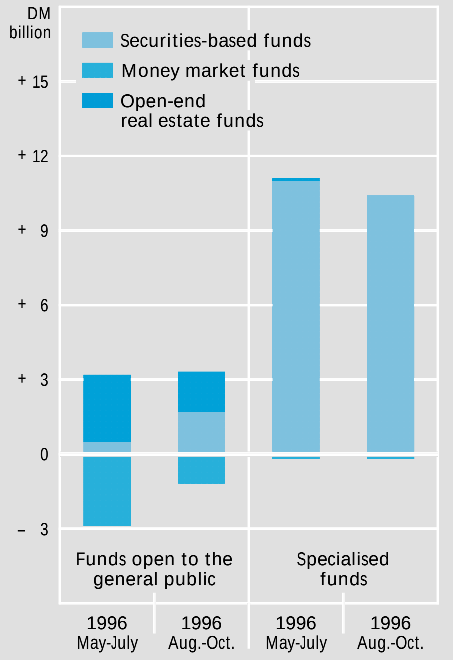
Amount raised

Between August and October the amount raised by sales of domestic investment certificates, at DM 12.2 billion, changed only marginally against the preceding period. At that time German funds had sold certificates to the tune of DM 11.6 billion (net); DM 8.6 billion had been raised in the corresponding period of 1995. The portfolio of foreign investment certificates held in Germany was virtually unchanged on balance between August and October. Altogether, sales of domestic and foreign investment fund certificates yielded DM 12.2 billion in the period under review, compared with DM 13.0 billion in the preceding three months and DM 8.2 billion a year before.

Specialised funds

Between August and October the amount raised, at DM 10.3 billion, went chiefly to the specialised funds. The specialised funds issued by the insurance enterprises gained in particular; they alone were increased by DM 5.1 billion. As in the previous periods, mixed funds recorded the largest inflows of funds (DM 6.1 billion). The bond-based funds and

Amount raised by domestic investment funds



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the share-based funds gained DM 3.7 billion and DM 0.6 billion, respectively. The money market funds among the specialised funds had to repurchase certificates to a small extent (– DM 0.1 billion).

Funds open to the general public

The amount raised by domestic funds open to the general public ran at a comparatively low level between August and October (at DM 1.9 billion net); compared with the three preceding months, when only DM 0.3 billion had been raised, transactions in the case of funds open to the general public picked up a little, however. This is, first and foremost, due to the fact that there was a slackening in outflows of funds in the case of domestic money market funds; in the entire period under review these outflows came to DM 1.2 billion, compared with DM 2.9 billion between May and July. In October the money market funds were able to sell certificates again for the first time since February 1996. Open-end real estate funds continued to meet with a good response (DM 1.6 billion). The share-based funds, which sold certificates to the tune of DM 1.0 billion, benefited from the sustained price increase in equities. The present restraint in purchases of debt securities was also reflected by a low level of interest in “indirect” investment in debt securities through bond-based funds; in this case only DM 0.5 billion was raised.

Purchases of investment fund certificates

Investment fund certificates were predominantly purchased by German non-banks. Between August and October they purchased fund certificates to the value of DM 8.8 billion, compared with DM 9.6 billion in the preceding quarter. These consisted exclusively of certificates of domestic funds (DM 9.6 billion), while foreign investment fund certificates were returned to the tune of DM 0.9 billion. Non-banks sold certificates of domestic and foreign money market funds totalling DM 2.1 billion. Credit institutions increased their holdings of investment fund certificates by DM 3.7 billion. On balance, foreign investors sold domestic fund certificates to the tune of DM 0.2 billion.