Securities markets

Debt securities market

Interest rate movements

Persistently low capital market rates

Around the turn of 1996-7 German capital market rates were at a very low level. In mid-January 1997 the yield on domestic debt securities outstanding, which had already reached a record low at the end of 1996 following the sharp decline in interest rates in autumn, fell below the 5 % mark for the first time. Thereafter, capital market rates fluctuated for a time within a narrow range around this figure; in mid-February the yield on domestic debt securities outstanding fell to a new all-time low of 4¾ %. The decline in yields after the beginning of 1997 affected virtually all maturity categories to a similar extent. Hence, the yield advantage of ten-year Federal bonds over paper with residual maturities of one year, which is discernible in the market, barely changed in the past few months; in mid-February it came to a little more than 2¼ percentage points. The yield curve in the German debt securities market thus remains steep, albeit at a low level.

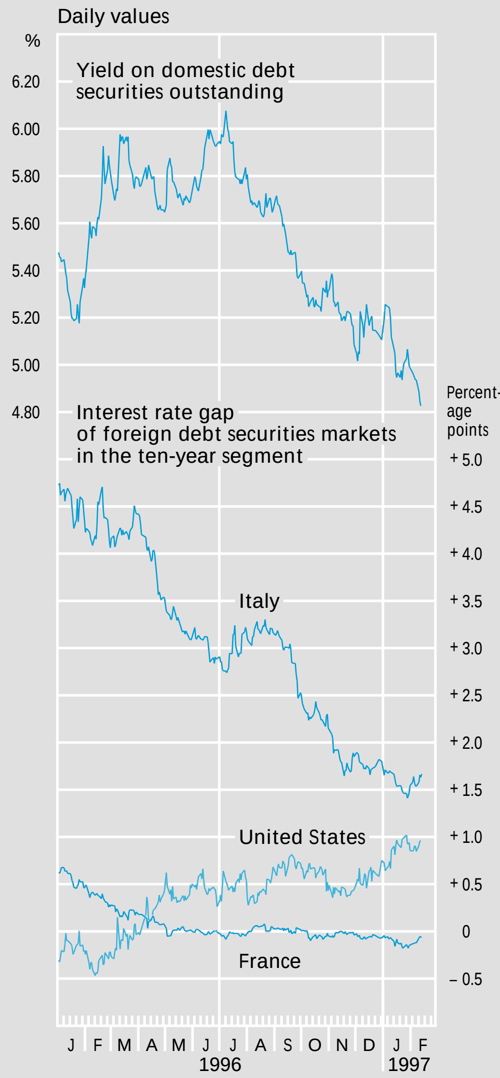
Interest rate trend within the international setting

Since the end of 1996 developments in the domestic debt securities market have decoupled somewhat more strongly from the interest rate trend in the US debt securities market. This owes much to the fact that the publication of a number of economic indicators has clearly shown that the two economies are at different points in the business cycle. On balance, the yield advantage of ten-year US Treasury paper over Federal bonds with comparable maturities doubled to 1 percentage point between the beginning of December 1996 and the end of January 1997. But the capital market was also influenced by the ongoing discussions on European monetary union. Against this background, the yields in most European countries – in particular in countries with traditionally high interest rates – declined more sharply than in Germany, so that interest rate differentials within Europe have continued to narrow.

Implications of the interest rate movements

Not least owing to the persistently low capital market yields, the underlying monetary conditions for a strong upturn in growth continue to be favourable. In real terms, too, long-term interest rates have been distinctly lower for some time now than, for example, on an average of the eighties; the "statistical" real interest rate (measured as the yield on debt securities outstanding adjusted for the current rate of price rises at the consumer level) came to around 3¾% in the last quarter of 1996, compared with about 4½% on average in the eighties. However, the new lows reached in capital market rates have been accompanied by a higher susceptibility to fluctuations, both in the German debt securities market and elsewhere, as the increase in volatility since the end of 1996 shows. The crucial need in this environment is not to allow any doubts to arise about the rigorous anti-inflationary stance of monetary policy and the steadfast fiscal consolidation efforts of the public sector, so as to obviate higher inflation and risk premiums in the capital market and to offer no sustenance for speculative exaggerations. Gearing monetary policy more strongly to business activity, a policy which the Bundesbank is occasionally urged to adopt in order to overcome the current investment weakness and unemployment, could easily backfire, however, because it could lead to credibility losses and higher capital market rates. Besides, the present real economic problems in Germany, which have predominantly structural causes, can only be solved by economic policy reforms and not by a policy of cheap money.

Interest rate movements in the debt securities market



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Sales of debt securities

Amount raised

Between October and December 1996 gross sales of domestic debt securities, at DM 182.4 billion (market value), were somewhat higher than in the preceding quarter, when German borrowers issued debt securities to the amount of DM 163.4 billion; in the last quarter of 1995 debt securities were sold to the tune of DM 181.2 billion gross. Less redemptions and adjusted for changes in issuers' holdings of own-debt securities, net sales came to DM 58.8 billion between October and December, compared with DM 51.7 billion in the three preceding months and DM 54.7 billion a year previously. The actual amount raised in the debt securities market, however, came to only DM 53.5 billion in the period under review, because the allotment to the volume of DM 5.2 billion of debt securities issued by the Currency Conversion Equalisation Fund was not connected with direct recourse to the market. In the fourth quarter of 1996 foreign debt securities were sold to the tune of DM 5.2 billion in the domestic market, as against DM 5.6 billion between July and September. While sales of foreign currency bonds declined in the German market (DM 3.6 billion, against DM 5.4 billion), domestic investors showed a greater appetite for Deutsche Mark debt securities issued by non-residents; on balance, such paper was sold to the tune of DM 1.6 billion in the domestic market, compared with only DM 0.1 billion in the previous quarter. Altogether, the amount raised by sales of domestic and foreign debt securities came to DM 58.8 billion between October and December 1996; it was thus on a par with the result in the previous quarter and only marginally smaller than in the fourth quarter of 1995 (DM 59.7 billion; in each case not counting the debt securities issued by the Currency Conversion Equalisation Fund).

Sales and purchases of debt securities

DM billion

Item	1996 July to Sep.	1996 Oct. to Dec.	1995 Oct. to Dec.
Sales			
Domestic debt securities 1	51.7	58.8	54.7
of which			
Bank debt securities	45.0	46.2	50.7
Public debt securities	6.6	12.0	3.9
Foreign debt securities 2	5.6	5.2	5.1
Purchases			
Residents	29.1	35.9	34.9
Credit institutions 3	21.0	20.2	38.0
Non-banks 4	8.0	15.7	– 3.0
of which			
Domestic debt securities	7.7	16.1	– 4.5
Non-residents 2	28.2	28.1	24.9
Sales and purchases, total	57.3	64.0	59.9

1 Net sales at market values plus/less changes in issuers' holdings of own-debt securities. — **2** Transaction values. — **3** Book values, statistically adjusted. — **4** Residual.

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Bank debt securities

Between October and December credit institutions received more than three-quarters of the amount raised by sales of domestic debt securities (DM 46.2 billion net). Issuing activity focused on the first two months of the period under review, whereas the amount of bank debt securities outstanding in December increased only slightly. With a volume of DM 30.0 billion, communal bonds *(Öffentliche Pfandbriefe)* continued to be to the fore. In this segment of the debt securities market the trend towards launching issues with a volume of DM 1 billion and more is unabated. The outstanding amount of such "jumbo mortgage bonds" more than doubled (to DM 141.1 billion) at the end of 1996, compared with the previous year, as did the number of such issues. The development in the case of "traditional" mortgage bonds *(Hypothekenpfandbriefe)* was far less dynamic. In the period under review only DM 1.3 billion (net) was raised by sales of such paper. Other bank debt securities were sold to the tune of DM 19.0 billion net. The outstanding amount of debt securities issued by specialised credit institutions declined by DM 4.2 billion. This was due mainly to redemptions of paper which had been issued in connection with the restructuring of the east German banking system.

Public debt securities

Between October and December 1996 the public sector drew on the debt securities market to a smaller extent overall than in the preceding three months. Public issuers' bonded debt rose by DM 6.8 billion in the period under review (excluding debt securities of the Currency Conversion Equalisation Fund), compared with DM 8.1 billion between July and September. This is ascribable, on the one hand, to the fact that public borrowers increasingly used other instruments – such as borrowers' note loans – to cover their persistently high credit requirements. On the other hand, a sizeable volume of paper issued by borrowers which no longer feature as issuers in the debt securities market was redeemed. Debt securities of the Treuhand agency were redeemed to the tune of DM 4.1 billion; the outstanding amount of debt securities issued by the post office and the railways declined by DM 3.1 billion and DM 1.3 billion, respectively. The Federal Government's borrowing in the debt securities market came to DM 14.3 billion in the last quarter of 1996. The outstanding amount of two-year Federal Treasury notes rose by DM 9.5 billion (nominal value). Sales of five-year special Federal bonds yielded DM 8.9 billion (net), while Federal savings bonds were sold to the extent of only DM 2.3 billion on balance. This was accompanied by fairly large redemptions of ten-year debt securities and four-year Treasury notes (DM 4.0 billion each). The Länder Governments drew on the debt securities market to the tune of DM 0.7 billion. Other public issuers' bonded debt changed only marginally.

Foreign Deutsche Mark bonds

Foreign borrowers issued debt securities denominated in Deutsche Mark to the tune of DM 27.3 billion (nominal value) between October and December 1996; these included a number of issues of South American newly industrialising countries, which have recently had greater recourse to the Deutsche Mark segment of the international capital market for their borrowing. Net sales of foreign Deutsche Mark bonds came to DM 18.6 billion in the period under review, compared with DM 14.3 billion between July and September 1996 and DM 16.0 billion in the corresponding period of 1995. The major part of such paper was sold to non-residents; domestic investors seemed to be particularly interested in paper issued by borrowers which do not have a first-class credit standing and therefore offer higher interest rates.

The Federal Government's second issue of short-running Treasury notes with a maturity

Short-dated debt securities issued by the public sector

of six months ("Bubills") headed the list in the market for short-dated debt securities issued by non-banks in the last quarter of 1996. The tender yielded DM 8.6 billion; the outstanding amount of such paper thus reached the limit of DM 20 billion agreed between the Federal Ministry of Finance and the Deutsche Bundesbank for 1996 and 1997. Roughly half of the second tranche of Bubills was sold to non-residents.

Deutsche Mark commercial paper

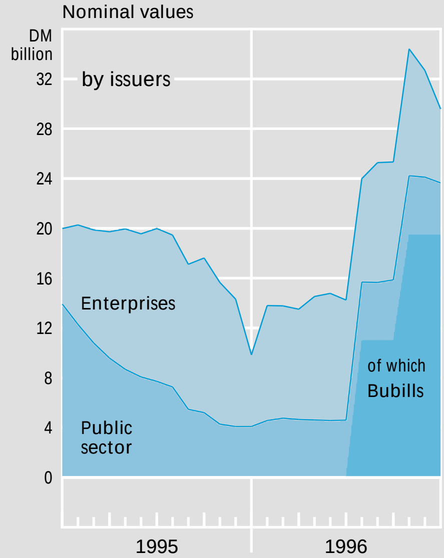
The market for Deutsche Mark commercial paper, which, like Bubills, is not included in the figures analysed here, was tapped distinctly less by domestic enterprises in the period under review than in the preceding quarter. The outstanding amount of commercial paper issued by residents declined by DM 3.6 billion to DM 5.9 billion. At the end of 1996 foreign non-banks' indebtedness in the form of commercial paper, at DM 13.7 billion, stood at about the same level as three months previously.

Purchases of debt securities

Buoyant foreign demand

Between October and December foreign investors continued to buy bonds in the German debt securities market on a large scale. Their purchases totalled DM 28.1 billion (net) during this period, compared with DM 28.2 billion in the three preceding months. Non-residents' acquisitions fluctuated sharply, however, during the period under review. In October foreign purchases came to only DM 0.7 billion, in November they rose to DM 21.2 billion, and in December they fell again to DM 6.3 billion. Foreign investors bought bank debt securities amounting to DM 15.9

Outstanding amount of short-term debt securities issued by domestic non-banks *



* Agreed maturity up to and including one year.

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billion and public debt securities to the tune of DM 12.2 billion. In addition to foreign currency bonds issued by German banks, which accounted for almost three-quarters of the net purchases of bank debt securities, they invested in particular in communal bonds and – as they had done at the time of the first issue in September – two-year Federal Treasury notes.

Credit institutions' debt securities holdings

Domestic credit institutions topped up their debt securities portfolios by DM 20.2 billion between October and December, compared with DM 21.0 billion in the three preceding months. On balance, credit institutions purchased exclusively bank debt securities (DM 21.6 billion). They sold public debt securities to the tune of DM 6.7 billion. This trend is partly a mirror image of the purchases of other investor groups, since credit institutions typically act as a buffer in the debt securities market in the short term. Banks' holdings of foreign debt securities rose by DM 5.6 billion in the period under review, the vast bulk (DM 3.1 billion) consisting of foreign currency bonds.

Livelier involvement of non-banks in the debt securities market

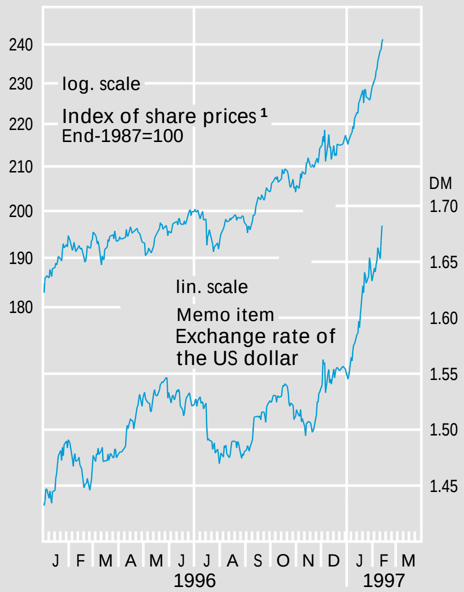
Domestic non-banks' interest in buying debt securities picked up towards the end of the year. In the fourth quarter they bought domestic debt securities on a distinctly larger scale, at DM 16.1 billion, than in the third quarter (DM 7.7 billion); but this was still far less than the quarterly average during the nineties (about DM 21 billion). Non-banks' heavier purchases overall appeared to conceal disparate trends in the case of households, on the one hand, and domestic institutional investors, on the other. While specialised funds, for example, bought a sizeable amount of debt securities in the fourth quarter of 1996, private investors apparently continued to show restraint. One indication of this were the sluggish net sales of Federal savings bonds (DM 2.3 billion), which are reserved for this group of buyers. Non-banks resold foreign debt securities worth DM 0.4 billion.

Share market

Share price trend

The sharp increase in share prices which began in the German equity market last year continued – after being punctuated by a phase of high volatility in December – with undiminished vigour at the beginning of 1997. In the first half of January alone, prices rose by 5 % on average (measured by the CDAX share price index). The driving forces behind the bull market were, first and foremost, the rapid strengthening of the US dollar from the turn of the year, which principally benefited the equity values of export-oriented firms, and the further decline in capital market interest rates, which boosted the attractiveness of share purchases vis-à-vis bond investments. Since the end of January share prices have notched up a number of additional all-time highs; in mid-February equity values were about 11 % higher than at the end of 1996.

Price movements in the share market



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

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Share sales

Issuing activity in the share market in the last quarter of 1996 was dominated by Deutsche Telekom's flotation in November. In total, domestic enterprises issued new shares to the record amount of DM 22.4 billion (market value), with 90 % of this sum accruing to the equity launch of Deutsche Telekom. Between July and September the issuing volume had amounted to DM 3.0 billion, while in the corresponding period of 1995 it had been DM 6.6 billion. Between October and December foreign participatory instruments were sold in the domestic market to the tune of DM 15.6 billion (net), compared with DM 6.0 billion in the three preceding months. The total amount raised by sales of domestic and foreign equities came to DM 38.0 billion between October and December, compared with DM 9.0 billion in the third quarter of 1996 and DM 11.4 billion in the corresponding period of 1995.

Share purchases

Domestic non-banks, which purchased equities totalling DM 23.7 billion net, were to the fore on the buyers' side of the German share market during the period under review. Only DM 7.7 billion of this sum was accounted for by German shares. This suggests that a number of initial buyers of Deutsche Telekom shares sold them again soon afterwards. In addition, shifts out of other domestic equities seem to have been made in response to the changed structure of the "market portfolio" brought about by the Deutsche Telekom issue. Non-banks' holdings of foreign shares increased by DM 16.0 billion. Domestic credit institutions purchased equities to the tune of DM 7.8 billion net, consisting on balance exclusively of domestic paper (DM 8.1 billion). In the last quarter of 1996 foreign investors bought German shares for DM 6.5 billion (net). As these purchases were focused on November (DM 6.6 billion), they presumably related mainly to transactions concerning the floating of Deutsche Telekom.

Sales and purchases of shares

DM billion

Item	1996 July to Sep.	1996 Oct. to Dec.	1995 Oct. to Dec.
Sales			
Domestic shares 1	3.0	22.4	6.6
Listed	0.9	21.9	4.8
Unlisted	2.1	0.5	1.7
Foreign shares 2	6.0	15.6	4.8
Portfolio purchases	0.7	9.8	– 0.0
Direct investment	5.2	5.8	4.8
Purchases			
Residents			
Credit institutions 3	– 2.9	7.8	4.4
Non-banks 4	11.9	23.7	11.1
of which Domestic shares	4.8	7.7	5.9
Non-residents 2	– 0.1	6.5	– 4.2
Sales and purchases, total	9.0	38.0	11.4

1 Market values. — 2 Transaction values. — 3 Book values, statistically adjusted. — 4 Residual.

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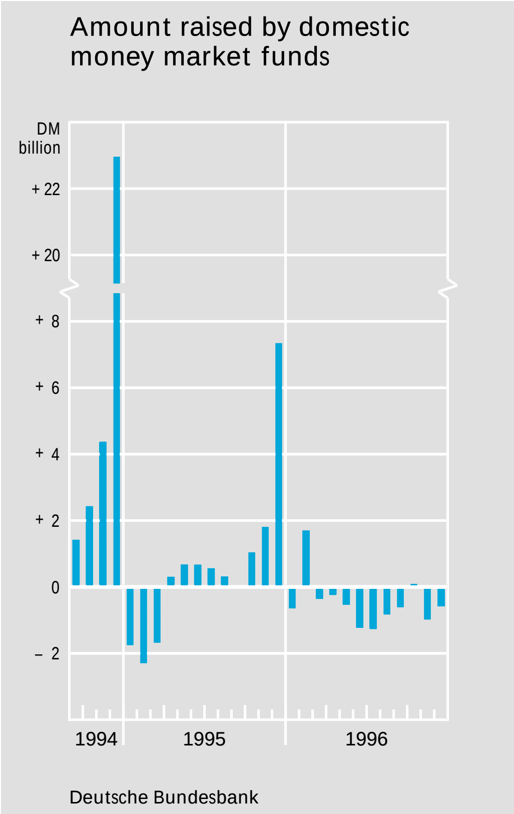
Investment funds

Amount raised

The amount raised by sales of domestic investment fund certificates, at DM 25.5 billion, increased heavily between October and December, compared with the three previous months. In the third quarter German funds had sold certificates to the extent of only DM 8.5 billion (net), whereas DM 30.2 billion had been raised in the fourth quarter of 1995. In the period under review residents purchased foreign investment fund certificates on a small scale (DM 0.1 billion). Aggregate sales of domestic and foreign investment fund certificates yielded DM 25.6 billion between Oc-



tober and December, compared with DM 9.0 billion in the previous quarter and DM 33.6 billion a year before.

Specialised funds

In the period under review, the increase in the amount raised by investment funds accrued almost exclusively to the specialised funds, which sold certificates to the amount of DM 23.0 billion (net). The mixed funds among them recorded the largest inflows (DM 12.6 billion). The bond-based funds and the share-based funds sold certificates totalling DM 7.1 billion and DM 3.4 billion, respectively. DM 0.2 billion was invested in open-end real estate funds. The money market funds among the specialised funds recorded small outflows of funds (– DM 0.1 billion).

Funds open to the general public

Demand for certificates of domestic funds open to the general public was again rather low between October and December. On balance, the funds open to the general public sold certificates totalling DM 2.5 billion, compared with DM 0.8 billion in the three preceding months; the funds open to the general public had raised DM 14.9 billion (net) in the final three months of 1995. This sales drop was caused mainly by outflows of resources from domestic money market funds, which persisted until the end of 1996; on balance, money market funds had to repurchase certificates to the value of DM 1.4 billion in the period under review, whereas they had sold certificates worth DM 9.4 billion (net) in the corresponding period of 1995. In addition to the low money market rates, this trend may have been prompted by the fact that, with the abolition of the wealth tax at the beginning of 1997, money market fund certificates (which – like other investment fund certificates – were subject to only half the standard wealth tax rate) lost part of their attractiveness. Furthermore, for some time now, banks have been increasingly offering deposit vehicles remunerated at near-market rates as rival products to money market funds. Open-end real estate funds sold certificates totalling DM 1.5 billion. Demand for share-based funds and bond-based funds picked up slightly, raising DM 1.1 billion and DM 0.9 billion, respectively. Mixed funds sold certificates worth DM 0.3 billion.

Purchases of investment fund certificates

Investment fund certificates were predominantly purchased by domestic non-banks. Between October and December they bought fund certificates to the value of DM 21.9

billion, compared with DM 6.4 billion in the preceding quarter. Non-banks exclusively purchased certificates of domestic funds (DM 22.6 billion), whereas they returned foreign investment fund certificates worth DM 0.7 billion. Non-banks resold certificates of domestic and foreign money market funds to the extent of DM 2.2 billion. Credit institutions' holdings of investment fund certificates rose by DM 5.5 billion. Foreign investors sold certificates of German funds worth DM 1.8 billion (net).