Securities markets

Bond market

Interest rate movements

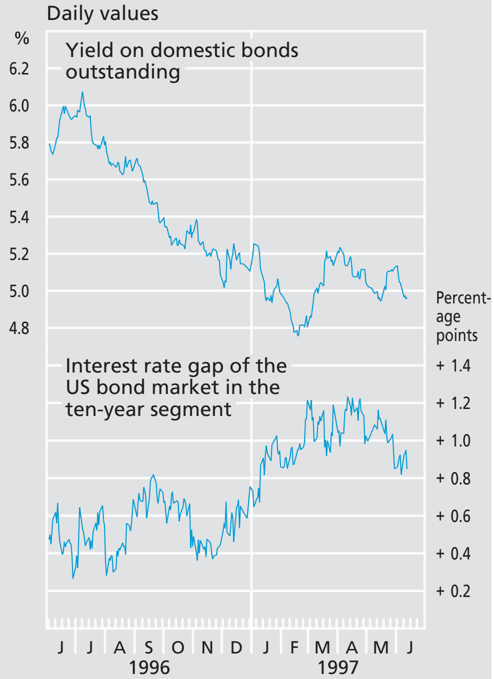
Persistently low capital market rates

German capital market rates continued to run at a low level in spring 1997. The yield on domestic bonds outstanding rose by ½ percentage point to 5 ¼ % between mid-February, when it had reached an all-time low (4 ¾ %), and mid-March. After that, it fell again, however, with some fluctuations. In mid-June the capital market rate, at just under 5 %, was about ¼ percentage point higher than at its low in February. The yield advantage of ten-year Federal bonds over paper with residual maturities of one year, which is discernible in the market, increased slightly from mid-February with only marginally changed conditions at the short end of the market; in mid-June it was 2 ½ percentage points. The yield curve in the German bond market thus continues to be steep.

Determinants of interest rate movements

The persistently low capital market rates in Germany are a reflection of the underlying conditions which have changed only marginally overall. Given a moderate rate of growth and, if anything, a deterioration in the situation on the domestic labour market, there are no signs so far of rising inflationary pressure. This assessment is underlined by the money stock trend, which, following strong growth at the beginning of the year, has now drawn closer to the target corridor. The German bond market was not affected by the US dollar's appreciation since the beginning of the year, which indicates that the capital market players tend to perceive this as a normalisation, but do not expect a sustained weak-

Interest rate movements in the bond market



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ening of the Deutsche Mark. Against that backdrop, the interest rate advantage of the US bond market, where emerging fears of inflation had led to a sharp increase of interest rates since February, continued to increase. From the end of February, the yield on ten-year US Treasury paper was mostly more than one percentage point higher than the yield on comparable German Federal bonds. At the end of May, the United States' interest rate advantage decreased again slightly; in mid-June it came to just under one percentage point.

Implications of the interest rate movements

The persistently low interest rates over the entire spread of maturities, together with the normalisation of the exchange rate relationships, led to a further brightening in spring of the monetary environment which is conducive to an acceleration of economic growth in Germany. It will now be of crucial importance to improve the structural conditions for investments in Germany, too, by undertaking resolute reform measures, which have the main aim of achieving a lasting budgetary consolidation and more flexible conditions on the labour market. Not only do these act as a direct stimulus to growth, they simultaneously help to safeguard low money and capital market rates.

Sales of bonds

Amount raised

Gross sales of domestic bonds were very brisk between January and April. Domestic borrowers issued bonds to the market value of DM 327.3 billion, compared with DM 246.1 billion in the previous four months and DM 285.8 billion between January and April 1996. In January 1997 issuing activity reached a new peak (DM 103.0 billion). Net of redemptions and after taking due account of changes in issuers' holdings of their own bonds, net sales in the first four months of the year came to DM 127.3 billion; this is distinctly more than between September and December 1996 (DM 78.2 billion) and a year before (DM 81.8 billion). Between January and April 1997 foreign bonds were sold in the domestic market to the tune of 20.0 billion, compared with DM 5.0 billion in the previous four months. This increase was due entirely to increased interest in foreign currency bonds on the part of domestic investors, who purchased such paper to the tune of DM 19.6 billion (net) in the period under review, compared with DM 3.1 billion in the previous period. Deutsche Mark bonds issued by non-residents were sold to the extent of DM 0.4 billion in the domestic market, and thus on a smaller scale than between September and December 1996 (DM 1.9 billion). Overall, the amount raised by sales of domestic and foreign bonds came to DM 147.3 billion between January and April, compared with DM 83.2 billion in the previous four months and DM 92.8 billion a year before.

Bank bonds

Between January and April, credit institutions received slightly more than two-thirds of the amount raised from sales of domestic bonds (DM 86.2 billion). The major part of this sum (DM 55.5 billion) consisted once again of communal bonds *(Öffentliche Pfandbriefe),* which are used to refinance lending to the public sector. The outstanding amount of such paper increased particularly sharply in both January (+ DM 23.7 billion) and February (+ DM 12.2 billion). DM 4.5 billion accrued to traditional mortgage bonds *(Hypothekenpfandbriefe).* Other bank bonds were sold to the tune of DM 21.2 billion (net). Sales of bonds of specialised credit institutions yielded DM 5.1 billion.

Public bonds

Between January and April, the public sector's recourse to the bond market by launching own issues was significantly greater than in the last four months of 1996. Public issuers' indebtedness in the bond market rose in the period under review by a total of DM 40.9 billion, compared with DM 10.5 billion between September and December 1996. This increase is almost entirely due to the Federal Government's heavier borrowing, which came to DM 49.1 billion on balance. In January and April, the Federal Government launched a new ten-year bond issue with a coupon of 6 % and an issue volume of DM 30 billion and DM 15 billion, respectively. Stripping of these two issues will be possible for the first time from July 1997. The outstanding amount of ten-year bond issues [1] rose by DM 28.9 billion, that of two-year interest-bearing Treasury paper by DM 13.7 billion (nominal values). On balance, sales of five-year special Federal bonds and Federal savings bonds yielded DM 6.9 billion and DM 2.9 billion, respectively. In addition, bonds of the Currency Conversion Equalisation Fund were allocated on an exchange basis with equalisation claims to the amount of DM 1.3 billion; these transactions, however, are not associated with direct recourse to the market. The large issues of

Sales and purchases of bonds

DM billion

Item	1996 Sep. to Dec.	1997 Jan. to Apr.	1996 Jan. to Apr.
Sales			
Domestic bonds 1	78.2	127.3	81.8
of which			
Bank bonds	67.1	86.2	74.8
Public bonds	10.5	40.9	7.4
Foreign bonds 2	5.0	20.0	11.0
Purchases			
Residents	52.8	102.1	62.0
Credit institutions 3	35.1	88.6	59.2
Non-banks 4	17.6	13.5	2.7
of which			
Domestic bonds	21.2	8.5	1.6
Non-residents 2	30.4	45.2	30.8
Total sales or purchases	83.2	147.3	92.8

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

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1 Including the bond issue launched in April with an original maturity of 10 years and 69 days.

the Federal Government were accompanied by maturities in the case of the Federal Post Office and the Federal Railways (– DM 2.0 billion and – DM 1.9 billion, respectively). The Länder Governments also redeemed their own bonded debt to the extent of DM 5.3 billion net. Other public issuers' indebtedness in the bond market changed only marginally.

Foreign Deutsche Mark bonds

Between January and April, foreign borrowers issued bonds denominated in Deutsche Mark to the extent of DM 38.5 billion (nominal value). Foreign public authorities (DM 10 billion), subsidiaries of German credit institutions (DM 9 billion) and international organisations (DM 3 billion) were the major groups of issuers. The differences in the credit standing of the issuers have tended to become larger. In addition to further issues of emerging market economies and countries in transition, some foreign enterprises with comparatively low credit standing also issued bonds (junk bonds). Net sales of foreign Deutsche Mark bonds came to DM 22.2 billion in the period under review, compared with DM 23.7 billion between September and December 1996 and with DM 27.0 billion in the corresponding period of 1996. Almost all of the paper (DM 21.8 billion) was sold abroad.

Short-dated issues of non-banks

The market for short-dated Deutsche Mark bonds issued by domestic non-banks[2] was less buoyant in spring, after the outstanding amount of Treasury discount paper *(Bubills)* running for less than one year had, in October, already reached the limit of DM 20 billion agreed between the Federal Ministry of Finance and the Deutsche Bundesbank. Overall, the outstanding amount of Deutsche Mark bonds issued by domestic non-banks with an agreed maturity of up to and including one year came to DM 34.8 billion at the end of April, compared with DM 29.7 billion at the end of 1996.

Deutsche Mark commercial paper

This growth is due entirely to the increased use of Deutsche Mark commercial paper by domestic enterprises. The outstanding amount of such paper almost doubled in the period under review (DM 11.7 billion at the end of April 1997, compared with DM 5.9 billion at the end of 1996). Foreign enterprises, however, had less recourse to the Deutsche Mark commercial paper market than before. At the end of April, the outstanding amount of Deutsche Mark commercial paper issued by non-residents came to DM 10.9 billion; it was thus DM 2.8 billion lower than at the end of 1996.

Purchases of bonds

Credit institutions' heavy purchases of bonds

Domestic credit institutions' bond portfolios rose by DM 88.6 billion between January and April, and thus much more sharply than in the periods used for comparison (DM 35.1 billion between September and December 1996, DM 59.2 billion a year before). As a result, credit institutions mainly purchased domestic bank bonds (DM 47.2 billion); banks' holdings of public bonds rose by DM 26.4 billion. Against the backdrop of a steep yield curve, declining purchases by non-

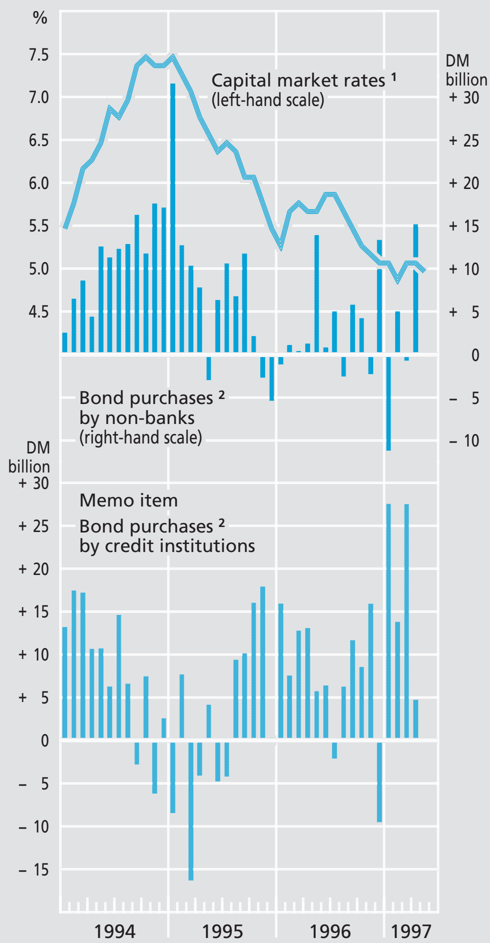
2 *Bubills* and commercial paper are not included in the sales figures analysed above; a listing of the outstanding amount of shorter-term bonds, which also includes these paper, can be found in Deutsche Bundesbank, Statistical Supplement to the Monthly Report 2, Capital market statistics, May 1997, Table II.10.

residents and the non-banks' pronounced "wait-and-see" attitude, banks performed maturity transformation through the domestic bond market on a large scale. They also sharply increased their holdings of bonds issued by non-residents (+ DM 15.0 billion); around two-thirds of these consisted of foreign currency bonds.

Declining purchases by non-residents

Foreign investors' purchases in the German bond market declined significantly during the spring. While foreign investors' net purchases came to DM 31.2 billion in January, their propensity to buy tailed off markedly given the temporary increase in interest rates in the following two months; it was only in April that foreign demand increased again slightly. Overall, purchases of foreign investors came to DM 45.2 billion (net) in the period under review, compared with DM 30.4 billion in the previous four months. Roughly half each of foreign purchases consisted of public bonds and bank bonds (DM 23.7 billion and DM 21.5 billion, respectively). In the case of bank bonds, non-residents' interest was focused on foreign currency issues, whereas demand was particularly brisk, among public paper, for the ten-year bonds launched in January and April.

Capital market rates and purchases of bonds by non-banks



1 Yields on domestic bonds outstanding. — **2** Net purchases or net sales of domestic bonds.

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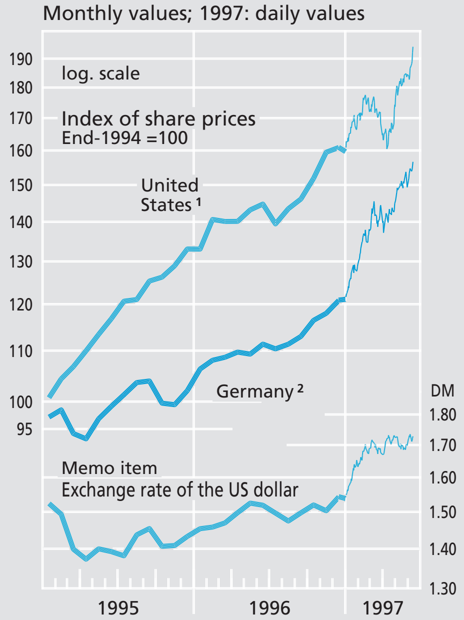
Non-banks' bond market purchases continued to be muted

Between January and April, domestic non-banks' bond purchases continued to run at a low level (DM 13.5 billion). Above all, the demand for domestic bonds weakened again perceptibly, at DM 8.5 billion, compared with 21.2 billion (net) in the last four months of 1996. Non-banks' purchases of bank bonds came to DM 17.5 billion, on balance, whereas public bonds were sold by them to the tune of DM 9.2 billion (net). The exceptionally low capital market rates were probably a major reason for non-banks' sluggish propensity to buy. It was not until April, when yields stabilised at a slightly higher level, that non-banks again purchased domestic bonds on a larger scale (DM 15.2 billion). Non-banks' holdings of foreign bonds rose during the period under review by DM 5.0 billion, Price movements in the equity market

Monthly values; 1997: daily values



1 Standard & Poors 500 index. — 2 CDAX share price index of Deutsche Börse AG.

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demand being exclusively for foreign currency bonds (+ DM 8.9 billion).

Equity market

Share price trend

The share price trend in the German equity market was pointing upwards in the last few months, too, despite setbacks in the interim. After heavy share price losses in mid-March and at the beginning of April, share prices (measured by the CDAX share price index) once again attained a series of new peaks in May and June. The latest record peak of mid-June signifies a price increase of more than 27 % compared with the end-of-year level for 1996. To a large extent, price movements in spring reflect the international influences throughout the market. Firstly, the strengthening of the US dollar against the Deutsche Mark mainly stimulated heavily export-oriented items, such as those of the chemicals and motor industries; recently, these two industries represented 18 % and 12 %, respectively, of all the common stocks and preference shares of domestic companies traded in Frankfurt, on which the calculation of the CDAX share price index is based. Secondly, the trend in the international equity markets had a major impact on domestic prices. That also applies to the further increase in prices and the setbacks in March and April, which immediately followed the price setbacks in the United States. These show that the German equity markets' pronounced dependence on non-residents also harbours some risks.

Share sales

In spring, sales in the equity market were significantly affected by foreign participating interests. Between January and April, foreign shares were sold in the domestic market with a record volume of DM 36.9 billion net, compared with DM 10.8 billion in the previous four months. More than three-quarters of this amount consisted of portfolio purchases. Domestic enterprises' new shares, however, were issued in the period under review only to the market value of DM 5.0 billion, compared with DM 23.7 billion in the preceding period (which was influenced by the flotation of Deutsche Telekom shares). The total amount raised by sales of domestic and foreign equities thus came to DM 42.0 billion in the first four months of the year. Between September and December, total sales came to DM 34.6 billion; during the corresponding period of 1996, DM 24.1 billion had been raised.

Sales and purchases of shares

DM billion

Item	1996 Sep. to Dec.	1997 Jan. to Apr.	1996 Jan. to Apr.
Sales			
Domestic shares [1]	23.7	5.0	6.1
Listed	22.2	3.8	4.2
Unlisted	1.5	1.2	1.9
Foreign shares	10.8	36.9	18.0
Portfolio purchases	8.7	29.6	13.8
Direct investment	2.1	7.3	4.2
Purchases			
Residents			
Credit institutions [3]	8.9	29.2	24.0
Non-banks [4]	16.7	18.3	3.7
of which			
Foreign shares	11.5	32.6	15.7
Non-residents [2]	8.9	– 5.5	– 3.6
Total sales or purchases	34.6	42.0	24.1

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

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Share purchases

Only domestic investors were on the buyers' side of the German share market between January and April. Among these, credit institutions predominated which, with net purchases of DM 29.2 billion, bought domestic participatory instruments on a large scale (DM 24.9 billion). Domestic non-banks purchased equities worth DM 18.3 billion net, with larger portfolio shifts from domestic paper to foreign shares. Foreign investors refrained from buying in the equity market during the period under review. After having purchased domestic equities to the tune of DM 8.9 billion in the last four months of the previous year, they now sold such paper to the amount of DM 5.5 billion net.

Investment funds

Amount raised

The amount raised from sales of domestic investment fund certificates almost doubled between January and April (DM 51.9 billion) compared with the previous period. At that time, German funds had sold certificates worth DM 26.8 billion (net); in the corresponding period of 1996 DM 37.2 billion (net) was raised. Foreign fund certificates were sold to the extent of DM 2.8 billion in the domestic market in the period under review. Overall, sales of domestic and foreign investment fund certificates yielded DM 54.7 billion (net) between January and April, compared with DM 26.1 billion in the previous four months and DM 40.7 billion a year before.

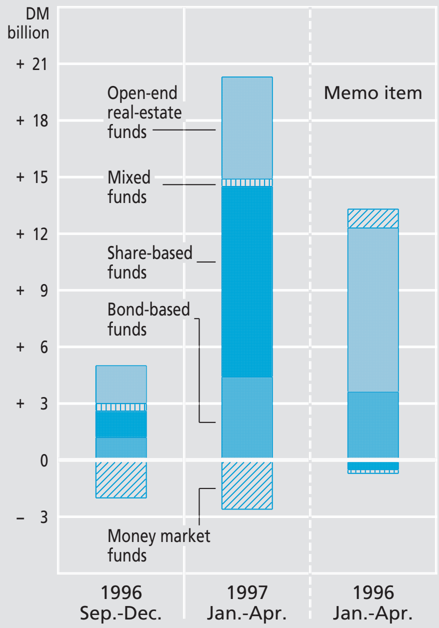
Specialised funds

The specialised funds, which are reserved for institutional investors, again received substantial amounts (DM 34.1 billion) in spring 1997. Mixed funds (DM 19.9 billion) continued to be to the fore. The bond-based funds and the share-based funds sold certificates to the tune of DM 10.9 billion and DM 3.3 billion net, respectively. Virtually no new funds were raised in the case of open-end real estate funds. Among the specialised funds, money market funds continued to play a very minor role.

Funds open to the general public

Demand for certificates of domestic funds open to the general public picked up noticeably between January and April. The amount raised by the funds open to the general public came to DM 17.8 billion during this period, compared with DM 3.0 billion in the previous four months and DM 12.6 billion a year before. This upturn is due, first and foremost, to

Amount raised by domestic funds open to the general public



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extremely large inflows to share-based funds (DM 10.1 billion). The sharp increase in these funds' assets placed in foreign shares (+ DM 10 billion or + 63 %) suggests that the desire to spread their own portfolio internationally was a major factor when buying certificates of share-based funds. Open-end real estate funds and bond-based funds, too, increased their holdings, at DM 5.4 billion and DM 4.4 billion net, respectively, which were thus distinctly higher than in the preceding period. Mixed funds raised DM 0.4 billion on balance. At – DM 2.6 billion, the money market funds among the funds open to the general public recorded heavy outflows of funds similar to those between September and December 1996 (– DM 2.0 billion).

Purchases of investment fund certificates

Investment fund certificates were predominantly purchased by domestic non-banks. Between January and April, they purchased fund certificates to the value of DM 43.7 billion, compared with DM 21.4 billion in the preceding four months. Their purchases were focused on domestic certificates (DM 40.9 billion net); they purchased foreign certificates to the tune of DM 2.8 billion net. On balance, non-banks redeemed certificates of domestic and foreign money market funds worth DM 3.8 billion. Credit institutions increased their holdings of investment fund certificates by DM 9.9 billion, purchasing almost exclusively domestic paper. Foreign investors purchased domestic fund certificates totalling DM 1.1 billion.