

## Securities markets

### Bond market

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During the summer months German capital market rates have fallen to new all-time lows. At the beginning of August the yield on domestic bonds outstanding fell below the 4½ % mark. Later in the month the decline in interest rates accelerated, and capital market rates fell for the first time below 4¼ %. At the same time volatility increased distinctly. By September 10 the yield outstanding had fallen to just over 4 %. The decline in interest rates was exceptionally pronounced at the long end of the market; between the end of May and mid-September yields on Federal bonds with a residual maturity of ten years fell by about ¾ percentage point. One-year yields, however, changed only marginally until the end of July and have fallen by a little more than ⅓ percentage point only since August. The yield curve has thus flattened out further; the yield spread between one-year and ten-year bonds was recently just under ⅔ percentage point.

*Interest rate movements*

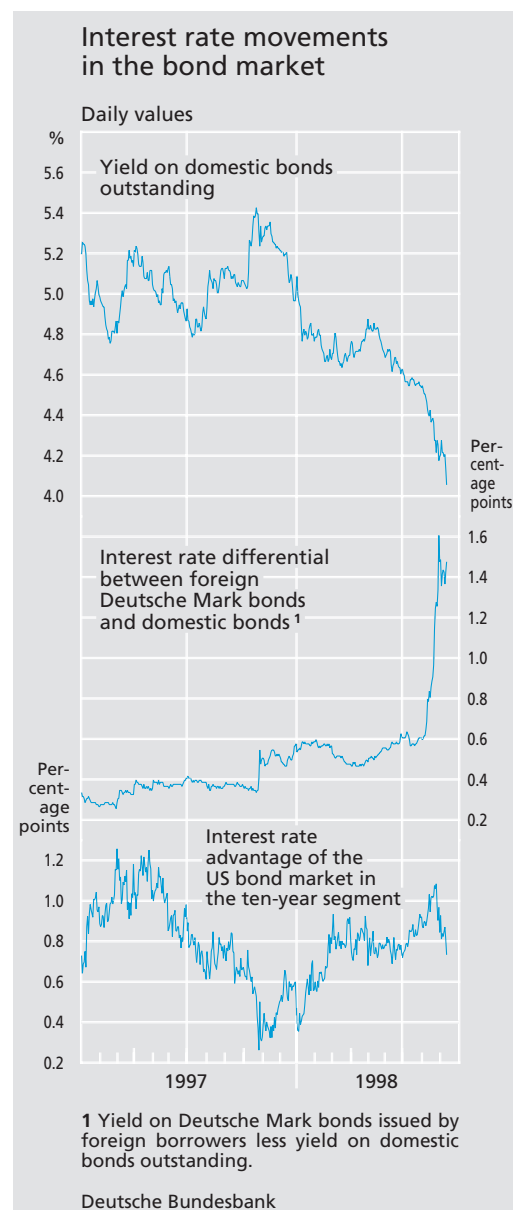
The interest rate trend during the summer has largely reflected the direct and indirect effects of the crises in East Asia and in Russia. In view of the growing uncertainties about future developments in these regions, investors continued to show a preference for markets with low credit and foreign exchange rate risks and high liquidity. Especially Russia's moratorium in August has apparently led to a reassessment of the credit risks associated with exposures in countries in transition and in emerging markets. As a result the yield spread in the case of issues with different credit ratings has increased substantially

*Determinants:  
change in risk  
premiums ...*

worldwide. Thus Deutsche Mark bonds launched by first class issuers have benefited from the continuing flight into "safe havens", while yields on foreign Deutsche Mark bonds issued by private and public borrowers from emerging markets have risen strongly. In August, for example, the yield advantage of Russian and South American government bonds denominated in Deutsche Mark and with a residual maturity of about five years over comparable (German) Federal bonds increased from about 10 and 3 percentage points, respectively, to 32 and 9 percentage points, respectively. A precondition for a reduction in the risk premiums in interest rates is the introduction in the debtor countries of resolute reforms which are capable of reviving investors' confidence. It is also important, however, to give the financial market players clear long-term guidance through a stable monetary framework in the industrial countries. Despite the general fall in the interest level, yield differentials have also increased in the case of paper issued by domestic borrowers. At the end of August ten-year bank bonds yielded about ½ percentage point more than comparable Federal bonds, compared with ¼ percentage point at the end of July, although differences in the levels of liquidity probably played an important role in both market segments.

... and  
favourable  
stability  
prospects

The general decline in interest rates in the German bond market was spurred by the moderating effects on prices in the goods markets as a result of the crises in East Asia. One example of these effects is the falling world market prices of important raw materials. Another factor was the declining unit la-



bour costs in the German market. Consequently, the falling interest rate level and the continued flattening-out of the yield curve are probably also signs that market participants are judging the long-term stability prospects favourably. Right into August, yields in Germany were actually falling somewhat more rapidly than in the United States. The interest rate advantage of ten-year US Treasury paper over (German) Federal bonds with

## Sales and purchases of bonds

DM billion			
Item	1998		1997
	May to July	Feb. to April	May to July
<b>Sales</b>			
Domestic bonds <sup>1</sup>	98.4	90.3	65.3
of which			
Bank bonds	81.4	78.7	53.4
Public bonds	15.8	10.5	10.9
Foreign bonds <sup>2</sup>	35.1	25.0	38.4
<b>Purchases</b>			
Residents	86.0	82.7	73.2
Credit institutions <sup>3</sup>	63.5	59.1	54.9
Non-banks <sup>4</sup>	22.5	23.6	18.3
of which			
Domestic bonds	10.5	11.9	-5.1
Non-residents <sup>2</sup>	47.5	32.6	30.5
<b>Total sales/purchases</b>	<b>133.5</b>	<b>115.3</b>	<b>103.7</b>

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

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comparable maturities increased to over 1 percentage point for a time. In most European bond markets the decline in interest rates was less pronounced than in Germany.

### Sales of bonds

#### Amount raised

Selling in the German bond market was quite buoyant between May and July. Domestic borrowers issued a smaller volume of bonds, with a gross market value of DM 247.8 billion, than in the previous three months (DM 275.9 billion), but distinctly more than between May and July 1997 (DM 202.7 billion). In July the issue volume actually reached a new peak (DM 108.1 billion). Net sales, after deducting redemptions and taking into account changes in issuers' holdings of their own bonds, were worth DM 98.4 billion and

therefore greater in the period under review than between February and April 1998 (DM 90.3 billion) and in the same period last year (DM 65.3 billion). Between May and July the foreign bonds sold in the domestic market amounted to DM 35.1 billion net, compared with DM 25.0 billion in the previous period and DM 38.4 billion between May and July 1997. Foreign currency bonds accounted for DM 21.4 billion of this amount and Deutsche Mark bonds issued by non-residents for DM 13.7 billion. Altogether, net sales of domestic and foreign bonds therefore amounted to DM 133.5 billion between May and July 1998, compared with DM 115.3 billion in the three preceding months and DM 103.7 billion a year earlier.

Most of the amount raised by sales of domestic bonds accrued to credit institutions. They issued bonds worth DM 81.4 billion net between May and July, compared with DM 78.7 billion in the three preceding months. The rise is due solely to heavy net sales of other bank bonds, which almost doubled, at DM 28.0 billion (February to April: DM 15.6 billion). This trend is connected with the banks' short and medium-term lending business with private customers, which has picked up again since the spring; accordingly, a comparatively large part of this business consisted of issues of shorter-term bonds (with maturities of up to and including four years). Net sales of communal bonds (*Öffentliche Pfandbriefe*), at DM 41.1 billion, were somewhat lower than in the three preceding months (DM 47.5 billion), a development which reflects the decline in bank lending to the public sector. The amount of outstanding bonds issued by spe-

*Bank bonds*

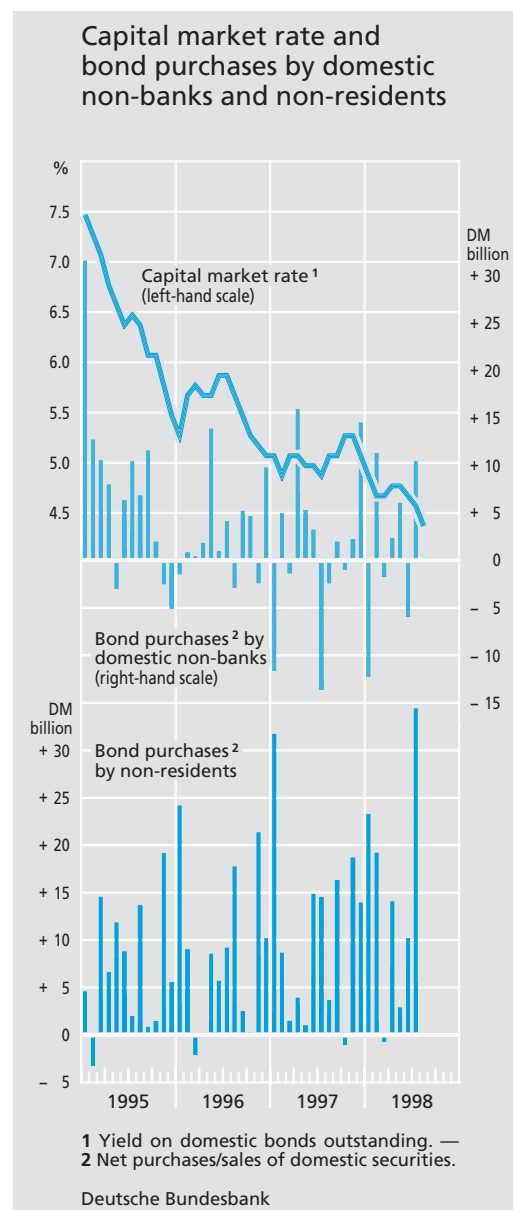
cialised credit institutions and that of mortgage bonds (*Hypothekendarlehenbriefe*) rose by DM 7.5 billion and DM 4.9 billion, respectively.

Public sector  
bonds

During the period under review the public sector obtained DM 15.8 billion net through issuing its own bonds on the bond market; this compares with DM 10.5 billion between February and April 1998. As in the previous period, it was only the Federal Government that drew on the bond market as a borrower. Its borrowing increased relatively consistently over the entire maturity range. Specifically, it sold two-year Treasury notes worth DM 9.7 billion, five-year special Federal bonds worth DM 9.1 billion, ten-year bonds worth DM 3.4 billion and 30-year bonds worth DM 8.6 billion. The outstanding amount of Federal savings bonds, which are reserved for private investors, fell by DM 0.6 billion (all amounts for the Federal Government are nominal values and without taking account of the changes in its own holdings). The outstanding amount of bonds issued by the Treuhand agency and the Currency Conversion Equalisation Fund declined by DM 7.2 billion and DM 1.7 billion net, respectively. The Länder Governments' bonded debt also declined (by DM 0.4 billion). The other public issuers' bonded debt changed only marginally.

Corporate  
bonds

Between May and July corporate bonds worth DM 1.2 billion were placed in the German bond market, compared with DM 1.1 billion in the three preceding months and DM 1.0 billion in the corresponding period of 1997. The new issues included not only bonds issued by industrial corporations but also a number of bonds with special condi-



tions, such as different repayment options, issued by financial sector companies.

Between May and July foreign borrowers issued bonds denominated in Deutsche Mark to the record amount of DM 55.0 billion (nominal value). Foreign public authorities and the financing subsidiaries of German enterprises each accounted for about DM 10 billion of this sum. There were virtually no

Foreign  
Deutsche Mark  
bonds

borrowers from emerging markets present as issuers. Net sales of foreign Deutsche Mark bonds came to DM 42.3 billion in the period under review and thus also reached a new peak. Between February and April 1998 the amount raised was DM 26.0 billion compared with DM 23.0 billion between May and July 1997. About two-thirds of such paper were sold to non-residents (DM 28.6 billion).

*Short-dated  
bonds issued  
by domestic  
non-banks*

The outstanding amount of short-dated bonds issued by German non-banks (with an agreed maturity of up to and including one year) – which are generally not included in the aforementioned sales figures for the bond market – declined somewhat in the period under review; the volume of these bonds at the end of July was DM 33.6 billion, compared with DM 35.3 billion at the end of April. This decline was due exclusively to the fact that domestic enterprises had issued a smaller volume of Deutsche Mark commercial paper. At the end of July the outstanding volume of such paper was DM 10.6 billion. Compared with April 1998 this represents a decline of DM 1.7 billion. The outstanding amount of public sector securities running for less than one year remained virtually unchanged, at DM 22.8 billion.

### Purchases of bonds

*Credit  
institutions'  
bond purchases*

Between May and July, German credit institutions were the major group of buyers in the German bond market with net purchases of DM 63.5 billion. Bonds issued by domestic banks accounted for two-thirds of these purchases (DM 43.0 billion). Banks added bonds issued by foreign borrowers and worth

DM 23.1 billion to their portfolios; most of these were foreign currency bonds (DM 18.1 billion). Credit institutions' holdings of public bonds declined by DM 2.2 billion. It was mainly in July, when the situation in the international financial markets was becoming more and more critical, that the banks sold such paper on a large scale (DM 9.0 billion net), apparently to non-residents for the most part.

Foreign investors' demand in the German bond market again rose sharply in the summer months. Between May and July they invested DM 47.5 billion net in German bonds, compared with DM 32.6 billion in the preceding period and DM 30.5 billion in the corresponding period of 1997. In July alone non-residents purchased German bonds – primarily paper issued by the public sector – worth DM 34.4 billion (net). The shift of investible funds into "safe havens" seems to have been one of the main motives for their investment operations in that month – especially in the light of the worsening situation in East Asia and Russia. Altogether, non-residents purchased bank bonds worth DM 27.3 billion and public bonds worth DM 20.2 billion between May and July.

*Non-residents'  
purchases  
again rise  
strongly*

In the period under review German non-banks' net purchases of bonds came to DM 22.5 billion, i.e. the same level as between February and April (DM 23.6 billion). Non-banks purchased foreign bonds worth DM 12.0 billion, compared with DM 11.7 billion in the previous period; DM 8.8 billion of this sum consisted of bonds denominated in Deutsche Mark. Non-banks' demand for

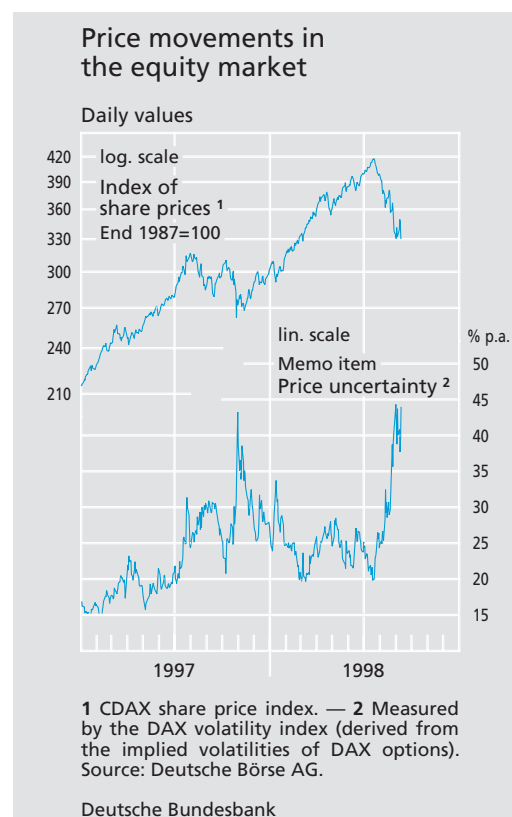
*Non-banks'  
demand  
picks up*

bonds issued by domestic borrowers declined overall; their purchases of such bonds amounted to DM 10.5 billion between May and July, compared with DM 11.9 billion in the previous three months, and consisted exclusively of bank bonds (DM 11.1 billion). Non-banks' interest in domestic bonds was focused on July, when they invested DM 10.4 billion (net) in such paper. The emerging decline in share market prices possibly encouraged a shift of investible funds, particularly in the case of institutional investors, into interest-bearing paper. This – and the considerable investment needs of institutional investors – might also be substantiated by the fact that in July sales of registered bank bonds which are not subject to price risks (and which are not included in the figures analysed here) also rose strongly.

## Equity market

### Slide in share prices

There was a strong downturn in the German equity market during the summer. The bullish period, which had begun in the autumn of 1997, continued until mid-July, but from then until the end of August prices fell by about 20% (measured by the comprehensive CDAX share price index). At the same time the uncertainty about future price trends increased distinctly. International factors were the main reason for the fall in prices in the German equity market. Burgeoning fears of a slowdown in economic activity in the United States were an initial burden. Then in August the critical situation in East Asia and, in particular, the rapidly escalating currency and debt crisis in Russia led to massive falls in



prices. Bank shares were particularly affected and by the end of August had lost about one-quarter of their value, compared with their record level in July. On September 10, German share prices – which were showing a persistently high rate of volatility – were 21% lower than in mid-July but still 10% higher than at the end of 1997.

Issuing in the German equity market was comparatively brisk throughout the period under review. Altogether, domestic enterprises issued new shares with a market value of DM 18.2 billion in the period under review, compared with DM 12.3 billion between February and April and DM 4.0 billion a year before. Capital increases by affiliated companies accounted for almost one-half of the new issues and enterprises in the motor industry

Share sales

## Sales and purchases of shares

DM billion			
Item	1998		1997
	May to July	Feb. to April	May to July
<b>Sales</b>			
Domestic shares <sup>1</sup>	18.2	12.3	4.0
Listed	17.2	11.2	3.2
Unlisted	1.0	1.1	0.8
Foreign shares <sup>2</sup>	54.7	53.8	12.7
Portfolio purchases	48.4	46.0	8.5
Direct investment	6.3	7.8	4.2
<b>Purchases</b>			
Residents	14.9	56.7	-11.7
Credit institutions <sup>3</sup>	-25.9	37.5	-11.9
Non-banks <sup>4</sup>	40.8	19.2	0.2
of which			
Foreign shares	58.4	50.3	13.8
Non-residents <sup>2</sup>	58.0	9.4	28.4
<b>Total sales/purchases</b>	<b>72.9</b>	<b>66.1</b>	<b>16.7</b>

<sup>1</sup> Market values. — <sup>2</sup> Transaction values. — <sup>3</sup> Book values, statistically adjusted. — <sup>4</sup> Residual.

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for one-fifth. Foreign equities worth DM 54.7 billion were sold in the domestic market between May and July, compared with DM 53.8 billion between February and April and DM 12.7 billion between May and July 1997; the bulk of these were portfolio investments by German residents. The total amount raised by sales of domestic and foreign equities, at DM 72.9 billion, actually exceeded the record reached between February and April (DM 66.1 billion); in the corresponding period of 1997 it had amounted to DM 16.7 billion.

Share  
purchases

Foreign investors predominated on the buyers' side of the German equity market between May and July; they purchased German equities to the record level of DM 58.0 billion, compared with DM 9.4 billion in the preceding three months and DM 28.4 billion a year

earlier. German non-banks purchased equities worth DM 40.8 billion net. Credit institutions sold equities worth DM 25.9 billion (net) – German paper (– DM 22.1 billion) and foreign paper (– DM 3.7 billion).

## Investment funds

The amount raised from sales of domestic investment fund certificates, at DM 36.4 billion, was slightly lower between May and July than in the preceding period (DM 42.0 billion); during the same period of the previous year it had come to DM 32.2 billion. Foreign fund certificates worth DM 5.2 billion were sold in the German market. The combined amount raised by sales of domestic and foreign investment fund certificates therefore came to DM 41.6 billion in the period under review, compared with DM 50.4 billion between February and April and DM 36.4 billion between May and July 1997.

Amount raised

Domestic specialised funds received DM 26.8 billion (net) between May and July. As usual, the specialised funds, which are used by institutional investors for their asset management, received most of their resources from insurance enterprises (DM 11.6 billion), credit institutions (DM 8.0 billion) and other enterprises (DM 5.8 billion), all amounts being net. Mixed funds recorded the largest amount raised (DM 17.0 billion). Bond-based funds and share-based funds received DM 7.3 billion net and DM 2.3 billion net, respectively, from the sales of their certificates.

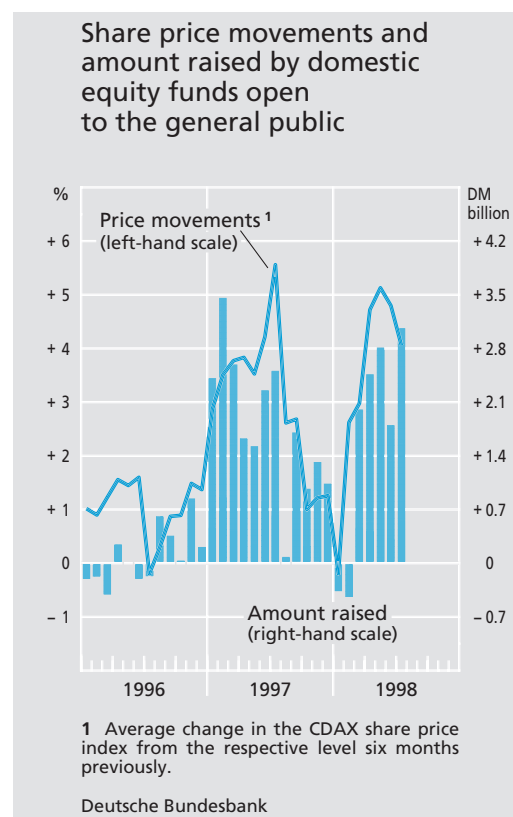
Specialised  
funds

*Funds open to  
the general  
public*

In the period under review, domestic funds open to the general public received distinctly less capital, at DM 9.6 billion, than in the previous period (DM 14.0 billion). The main reason for this decline was that investors were less interested in mixed funds and bond-based funds, which sold certificates worth only DM 0.8 billion and DM 0.1 billion, respectively (compared with DM 2.8 billion and DM 3.4 billion, respectively, in the previous period). The money market funds, too, recorded distinctly smaller inflows, at DM 0.5 billion, than in the previous period, when they had sold certificates worth DM 3.1 billion. Only the share-based funds were in a position to improve their results. They benefited from the sharp increase in share prices which lasted well into July and received DM 7.7 billion net. As in the previous period, open-end real estate funds received inflows of capital to the extent of DM 0.6 billion.

*Purchases of  
investment  
fund  
certificates*

Between May and July investment fund certificates were sold exclusively to domestic investors. As usual, domestic non-banks were to the fore, with net purchases amounting to DM 32.3 billion, compared with DM 42.8 billion in the preceding three months. They were again primarily interested in domestic



certificates (DM 27.2 billion); their holdings of foreign fund certificates rose by DM 5.1 billion. Non-banks purchased certificates of domestic and foreign money market funds worth DM 1.6 billion net. During the period under review German credit institutions bought DM 9.5 billion worth of investment fund certificates. Foreign investors sold certificates of German funds worth DM 0.3 billion.