Securities markets

Bond market

Interest rate movements

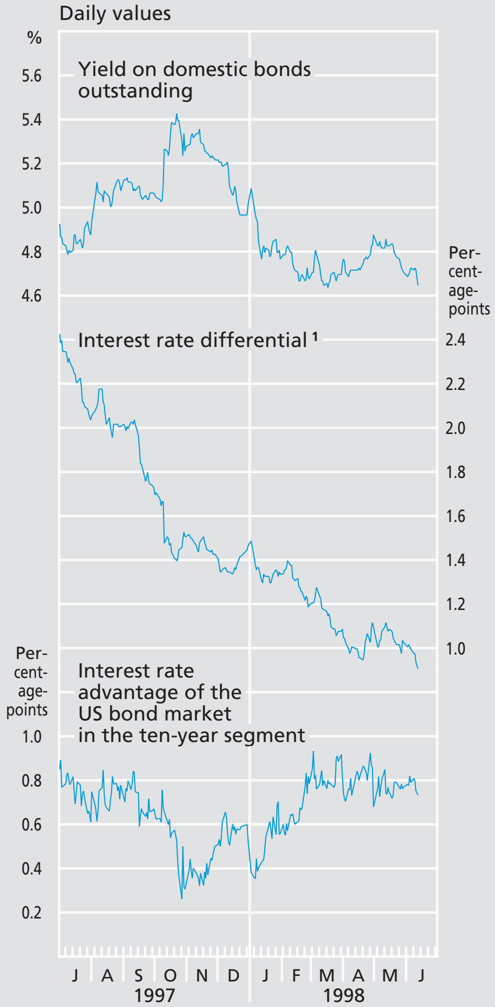
Following the sharp decline lasting until well into March, German capital market rates stabilised at an exceptionally low level. In mid-March, the yield on domestic bonds outstanding reached yet another all-time low, at less than 4¾%, and was thus around ½ percentage point lower than in December of last year. Since then, it has been rising slightly, amid minor fluctuations. In mid-June, in the wake of the renewed tension in East Asia, capital market rates dropped again to their low of March. Whereas interest rates on ten-year bonds were largely in line with the overall market trend, the yield on one-year Federal bonds reached its nadir as early as February and then rose by around ¼ percentage point. The yield curve thus flattened further. In April, the yield spread between ten-year and one-year bonds observable in the market fell below the mark of 1 percentage point for the first time since the spring of 1994. Owing to the persistently low rates of interest, the terms of financing for the economy continue to be favourable across the board. Real interest rates in the German capital market, too, are relatively low. Calculated as the yield on domestic bonds outstanding less the current rate of price increases at the consumer level, they amounted to only around 3½% over the course of this year so far.

Determinants of interest rate movements

The initial decline in interest rates, followed by a relatively stable interest rate trend in the German bond market, primarily reflects the favourable inflation outlook, which was not impaired by the slightly more buoyant level of business activity and the raising of the standard value-added tax rate at the beginning of April. The fact that the important decisions concerning the concrete shape of Stage Three of European monetary union did not trigger any fundamental interest rate movements shows that the markets expect monetary stability even in the period after the beginning of monetary union.

The global economic environment also contributed significantly to maintaining the low interest rate level and a high degree of stability in the German bond market. Budding inflationary fears, and corresponding expectations of interest rate increases, particularly in the United States, have been partly allayed not least by the cyclically decelerating and price-dampening effects of the crises in East Asia. At the same time, the latter have led to sizeable inflows of assets into "safe havens", thereby reinforcing the interest rate trend in those areas. Investors are apparently still willing to accept low yields on investments with low credit risk, liquidity risk and exchange-rate risk. Against this background, US capital market rates have hardly changed compared with December 1997, which means that the interest rate advantage of ten-year US Treasuries over comparable Federal German bonds, after having expanded at the beginning of the year, has settled at just over ¾ percentage point since the end of February.

Interest rate movements in the bond market



1 Yield differential between ten-year and one-year Federal bonds.

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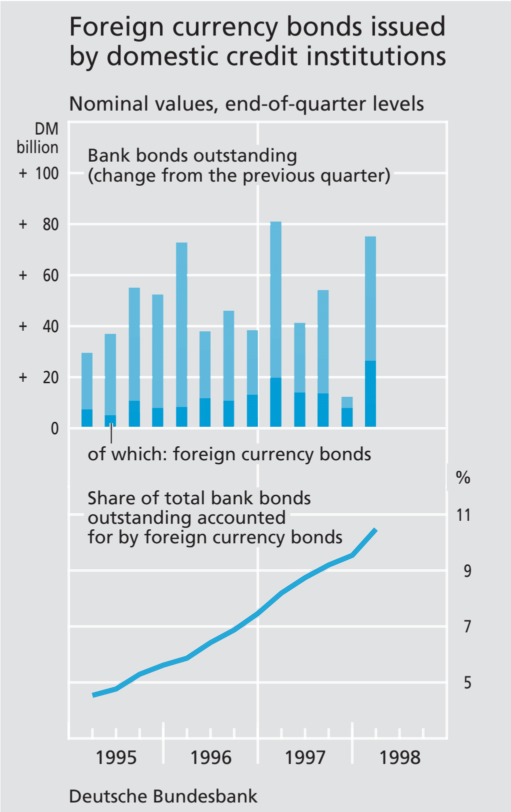
Sales of bonds

Amount raised

Sales activity in the German bond market was very buoyant between January and April. With gross sales worth DM 380.3 billion, domestic borrowers issued a distinctly larger volume of bonds than in the four preceding months (DM 257.7 billion) and from January to April 1997 (DM 327.3 billion). Net sales, after deducting redemptions and taking into account changes in issuers' holdings of their own bonds, at DM 126.7 billion, were nearly three times as high in the first four months as between September and December 1997 (DM 44.5 billion) but were on a par with the first four months of 1997 (DM 127.3 billion).



Foreign bonds, too, encountered keen interest among German investors from January to April; their sales in Germany totalled DM 32.5 billion on balance, compared with DM 14.3 billion in the preceding period and DM 20.1 billion in the first four months of 1997. In particular, demand for bonds denominated in foreign currency increased distinctly. During the period under review, domestic purchasers invested DM 22.3 billion net in such paper, compared with DM 9.1 billion between September and December 1997. But purchases by domestic investors of DM-denominated debt securities issued by non-residents, at DM 10.3 billion, were also well up on the last four months of 1997 (DM 5.1 billion). Combined net sales of domestic and foreign bonds reached DM 159.2 billion between January and April 1998, compared with DM 58.8 billion in the four preceding months and DM 147.4 billion in the same period of last year.

Bank bonds

The lion's share of the amount raised by sales of domestic bonds accrued to credit institutions. They issued bank bonds worth a net total of DM 105.2 billion between January and April, compared with only DM 32.7 billion in the preceding period. The credit institutions made extensive use of bonds denominated in foreign currency for refinancing purposes; the amount of such paper in circulation rose in the period under review by DM 33.3 billion. Sales of communal bonds *(Öffentliche Pfandbriefe)* generated a total of DM 70.7 billion, with large-volume "jumbo bonds" predominating. Other bank bonds were sold to the extent of DM 14.2 billion on balance. The amount of bonds issued by specialised credit institutions and of mortgage bonds *(Hypothekenpfandbriefe)* circulating in the market rose by DM 10.3 billion and DM 10.1 billion, respectively.

Public sector bonds

At DM 20.4 billion net, the public sector drew on the bond market during the period under review about twice as much, through issuing its own bonds, as it had done between September and December 1997 (DM 11.4 billion). However, it was only the Federal Government that took recourse to the bond market as an issuer; it sold bonds for DM 31.7 billion on balance exclusively in the short and long-term maturity segments, as has been the case for quite some time. Specifically, it sold 30-year and ten-year Federal bonds to the tune of DM 17.8 billion and DM 16.4 billion, respectively, and two-year Treasury notes for DM 13.0 billion. By contrast, mediumterm borrowing in the form of five-year special Federal bonds and Federal savings bonds declined further, by DM 2.5 billion and DM 1.8 billion, respectively. The amount of outstanding four-year Treasury notes, which the Federal Government ceased to issue quite a while ago, decreased by DM 4.0 billion; in addition, a twelve-year bond was redeemed in the amount of DM 3.0 billion (all individual amounts for the Federal Government are nominal values). Debt securities issued by the Treuhand agency were redeemed to the volume of DM 7.2 billion. The outstanding amounts of debt securities issued by the former Federal Post Office Fund and the Federal Railways Fund were reduced by DM 2.0 billion and DM 1.9 billion, respectively. The bonded debt of the Länder Governments was also run down in the period under review (by DM 0.5 billion), even though they tapped the bond market in April to a fairly major extent (DM 3.1 billion). The bonded debt of other public borrowers showed little change.

Corporate bonds

In the first four months of the year, corporate bonds worth a net total of DM 1.1 billion were placed in the German bond market. The issue volume of such paper had only ever reached a similarly high amount in the spring of 1997. With an outstanding nominal volume of DM 6.0 billion, the market for corporate bonds is still insignificant, though.

Foreign bonds denominated in Deutsche Mark

Between January and April, foreign borrowers issued bonds denominated in Deutsche Mark to the nominal value of DM 57.7 billion gross. About DM 14 billion of this was accounted for by foreign subsidiaries of German financial institutions, DM 9 billion by foreign

Sales and purchases of bonds

DM billion

Item	1997 Sep. to Dec.	1998 Jan. to April	1997 Jan. to April
Sales			
Domestic bonds 1	44.5	126.7	127.3
of which			
Bank bonds	32.7	105.2	86.2
Foreign bonds 2	14.3	32.5	20.1
of which			
Foreign currency bonds	9.1	22.3	19.3
Purchases			
Residents	10.8	103.4	101.6
Credit institutions 3	– 12.5	92.0	88.6
Non-banks 4	23.3	11.4	13.0
of which			
Foreign bonds	5.6	10.8	5.1
Non-residents 2	48.0	55.8	45.8
Total sales/purchases	58.8	159.2	147.4

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

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public authorities, and DM 3 billion by international organisations. Net sales of foreign Deutsche Mark bonds amounted to DM 32.1 billion in the period under review, compared with DM 15.1 billion between September and December 1997 and DM 22.2 billion in the corresponding period a year ago. Around two-thirds of this was sold to non-residents (DM 21.8 billion).

Short-dated bonds issued by domestic non-banks

The outstanding amount of short-dated bonds issued by domestic non-banks (with an agreed maturity of up to and including one year) – which are not included in the aforementioned sales figures for the bond market – increased somewhat at the beginning of the year; at the end of April, the total was DM 35.3 billion, compared with DM 31.0 billion at the end of 1997. This increase was due almost exclusively to the increased use of Deutsche Mark-denominated commercial paper by domestic enterprises. At the end of April, the outstanding volume of such paper was DM 12.3 billion. Compared with December 1997, this represents an increase by around half, although at that time sizeable redemptions were made – as is usual at the end of the year. The outstanding amount of public sector securities running for less than one year, at DM 23.0 billion at the end of April, remained virtually unchanged compared with the end of 1997.

Purchases of bonds

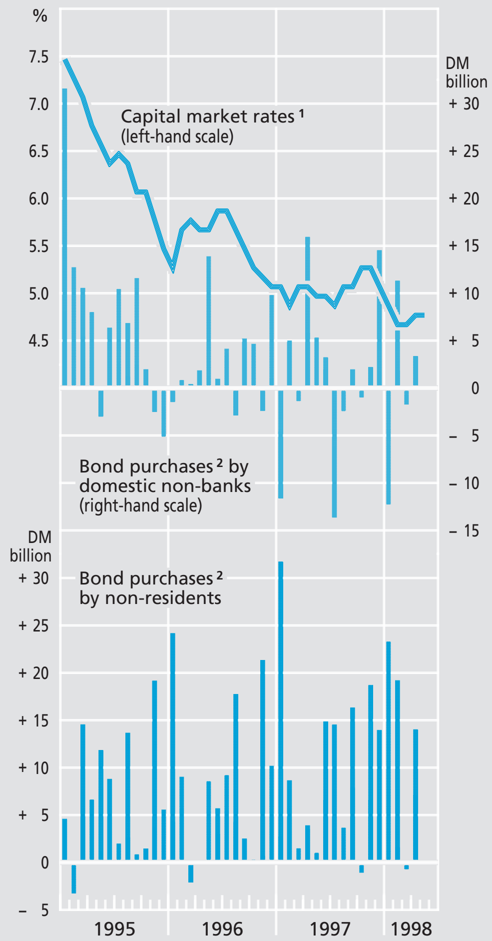
Large volume of bonds purchased by credit institutions

At DM 92.0 billion, German credit institutions replenished their bond portfolios between January and April to a similarly large extent as a year ago (DM 88.6 billion), after having reduced them by DM 12.5 billion between September and December. Securities lending transactions played a major role in this. The banks purchased sizeable amounts of both domestic bank bonds (DM 40.5 billion) and public bonds (DM 29.3 billion) as well as foreign bonds (DM 21.7 billion). The latter were almost exclusively bonds denominated in foreign currency.

Persistently large level of purchases by non-residents

Foreign investors continued to purchase German bonds on a large scale. Between January and April they invested DM 55.8 billion (net) in such paper, compared with DM 48.0 billion in the preceding period and DM 45.8 billion in the first four months of 1997. In contrast to the autumn of 1997, investment by non-residents focused on bank bonds (DM 45.5 billion). The continuously buoyant foreign demand is probably linked to the fact that, in the wake of the crises in East Asia and given the uncertain situation in the international financial markets, assets continued to be shifted to "safe havens".

Capital market rates and bond purchases by domestic non-banks and non-residents



1 Yield on domestic bonds outstanding. — 2 Net purchases/sales of domestic securities.

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Muted demand from non-banks

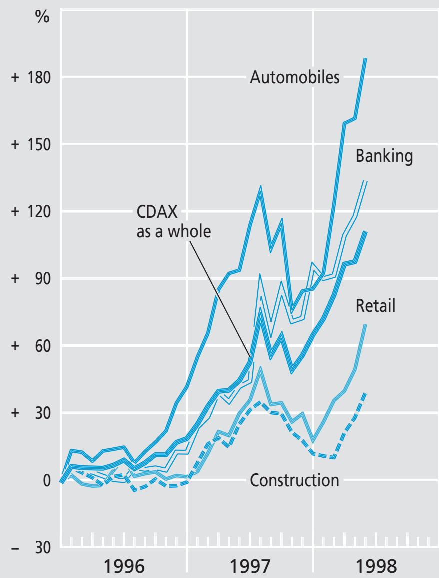
The demand of domestic non-banks for bonds, by contrast, remained muted. Their purchases of bonds, totalling DM 11.4 billion between January and April, were around half the value of the preceding period (DM 23.3 billion). Moreover, they focused on foreign bonds (DM 10.8 billion, including DM 8.4 billion in Deutsche Mark-denominated foreign bonds). They raised their stocks of domestic debt securities by only DM 0.6 billion. Apparently non-banks continue to regard the current interest-rate level as unusually low and relatively unattractive for long-term investment. They sold public bonds to the tune of DM 19.2 billion, on balance. On the other hand, non-banks purchased bank bonds, in some cases denominated in foreign currencies, to the extent of DM 19.1 billion.

Equity market

Continuing boom on the stock market

Against the background of the low money market and capital market rates, as well as the general boom on the North American and European stock exchanges, the share price upswing in the German equity market continued during the course of this year and led to new highs. Despite temporary downswings in January, the second half of April and the end of May, the comprehensive CDAX share price index was 29 % higher in mid-June than at the beginning of the year. The prices of automobile stock (+ 55 %) and mechanical engineering shares (+ 54 %) as well as retail equities (+ 44 %) rose particularly sharply up to the end of May. In addition to the continuing favourable situation in the export sector, the improved domestic economic climate is likely to have played a major role. Takeover rumours and proposed mergers gave the market added impetus.

Rise in share prices in selected sectors *



* Measured in terms of the percentage change in the respective CDAX price index from its level at the end of 1995.

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Share sales

In the first four months of the year, domestic enterprises issued new shares with a combined market value of DM 14.3 billion, as opposed to DM 10.4 billion between September and December 1997 and DM 5.0 billion a year ago. Around one-third each of the issue volume consisted of capital increases by enterprises in the automobile and mechanical engineering industries and in the financial sector. Foreign equities were sold for DM 71.1 billion between January and April; the bulk of these were portfolio investments by domestic investors. Sales of foreign equities were thus clearly higher than between September and December 1997 (DM 28.7 billion) and a year ago (DM 39.9 billion). Total sales of both domestic and foreign shares, at DM 85.4 billion, easily surpassed the value sold between September and December 1997

Sales and purchases of shares

DM billion

Item	1997 Sep. to Dec.	1998 Jan. to April	1997 Jan. to April
Sales			
Domestic shares 1	10.4	14.3	5.0
Listed	9.1	13.0	3.8
Unlisted	1.3	1.3	1.2
Foreign shares 2	28.7	71.1	39.9
Portfolio purchases	12.1	53.9	32.1
Direct investment	16.6	17.1	7.8
Purchases			
Residents	37.9	77.7	54.8
Credit institutions 3	– 7.9	50.0	29.2
Non-banks 4	45.8	27.7	25.6
of which:			
Foreign shares	28.2	68.2	35.6
Non-residents 2	1.3	7.6	– 9.9
Total sales/purchases	39.1	85.4	44.9

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

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(DM 39.1 billion) and the figure for the first four months of last year (DM 44.9 billion).

Share purchases

Domestic credit institutions predominated on the buyers' side of the German equity market between January and April; they purchased shares totalling DM 50.0 billion – often as part of reversible transactions. This involved almost exclusively domestic equities. By contrast, domestic non-banks played a somewhat lesser role, with net purchases totalling DM 27.7 billion; however, this masked considerable portfolio shifts out of domestic (– DM 40.5 billion) and into foreign equities (DM 68.2 billion). Foreign investors purchased a net total of DM 7.6 billion worth of equities in the first four months of the year, compared with purchases of DM 1.3 billion between September and December 1997 and sales totalling DM 9.9 billion in the same period last year.

Investment funds

Amount raised

The amount raised from sales of certificates of domestic investment funds between January and April, at DM 60.9 billion, was distinctly higher than in the preceding period (DM 44.9 billion) and in the first four months of 1997 (DM 51.9 billion). There was a buoyant demand for foreign investment fund certificates, too (DM 11.3 billion). The combined amount raised by sales of domestic and foreign mutual fund units in the period under review thus came to DM 72.3 billion.

Specialised funds

At DM 43.7 billion, a record amount accrued in the first four months of the year to the domestic specialised funds, which are reserved for institutional investors. Besides tax benefits and accounting advantages, the ability to invest more flexibly – in the case of derivatives, for example – was probably an additional contributory factor in the rapid growth of the specialised funds, which has been going on for quite some time now. At DM 31.3 billion, mixed funds again attracted the largest amount. Bond-based funds and share-based funds sold certificates worth DM 7.2 billion and DM 4.6 billion, respectively. Open-end real estate funds received DM 0.6 billion (net).

Investment funds open to the general public

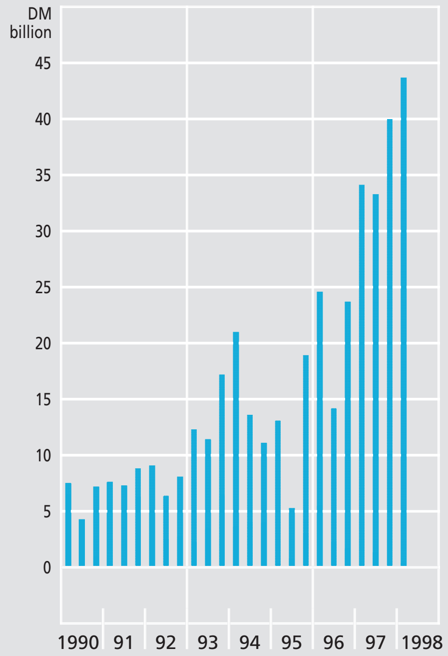
The domestic funds open to the general public sold certificates worth DM 17.3 billion, which was distinctly more than in the previous period (DM 4.8 billion); however, this still did not quite match the figure of DM 17.8 billion reached in the first four months of 1997. The sales proceeds were spread relatively evenly across the various types of funds. Bond-based funds and share-based funds generated inflows of DM 4.2 billion and DM 3.7 billion (net), respectively. Money market funds and mixed funds sold certificates worth DM 3.7 billion and DM 3.0 billion, respectively. Open-end real estate funds attracted DM 2.7 billion worth of new resources.

Purchases of investment fund certificates

Between January and April, investment fund certificates were purchased exclusively by domestic investors. As usual, domestic non-banks were to the fore, with net purchases totalling DM 58.0 billion, compared with DM 40.9 billion in the preceding four months. Once again they were interested mainly in domestic certificates (DM 45.9 billion); they replenished their portfolios of foreign fund certificates by DM 12.1 billion. Non-banks purchased DM 5.5 billion of certificates in domestic and foreign money market funds, on balance, after they had almost exclusively sold such paper in the preceding two years

Amount raised by domestic specialised funds

Four-month periods



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(for a total of DM 19.5 billion). During the period under review, domestic credit institutions bought DM 14.3 billion worth of investment fund certificates. Foreign investors sold certificates of German mutual funds in the amount of DM 0.1 billion.