

Financial markets in Germany

Capital-market and bank interest rates

During the winter, German capital-market rates moved in close step with yields in the other EMU countries, with ten-year Federal bonds all yielding almost one-quarter of a percentage point below the EMU average. Between the end of September and the beginning of January, the yield on ten-year Federal bonds outstanding rose by one-half of a percentage point to just over 5½%. It was still standing at that level when this Report went to press in mid-February. In the interim, however, the long-term capital-market rate increased to 5¾%, although it temporarily dropped back to below 5½% in connection with the interest rate hike by the Eurosystem early in February. The interest rates of Federal securities with shorter residual maturities, which are more affected by changes in money-market conditions, have gone up rather more steeply than the rates of long-dated securities in recent months. The spread of interest rates on Federal securities has therefore narrowed during the period under review. In mid-February the interest-rate advantage of ten-year Federal bonds over one-year paper discernible in the market came to 1½ percentage points, compared with more than 1¾ percentage points at the end of September.

Further rise in capital-market rates and flattening-out of the yield curve

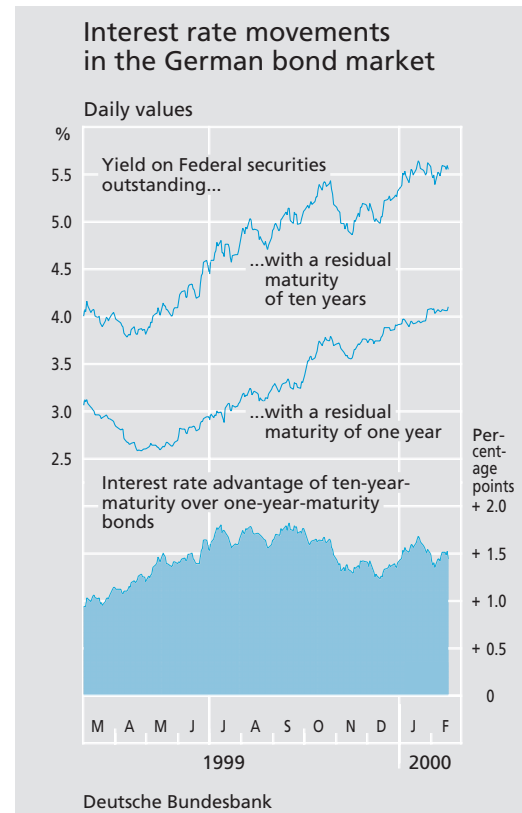
The interest-rate gap between ten-year debt securities issued by domestic banks and comparable Federal bonds narrowed slightly after the turn of the year. At an average of almost 40 basis points, however, it is still somewhat wider than in the first half of 1999. The reduction is mainly ascribable to the movement

Risk spreads in the bond market slightly narrower

of the rather less liquid other bank debt securities; in the ten-year segment, their interest-rate advantage over ten-year Federal bonds has latterly been roughly in line with the average of all bank debt securities, whereas it had amounted to over 50 basis points at times in November and December.

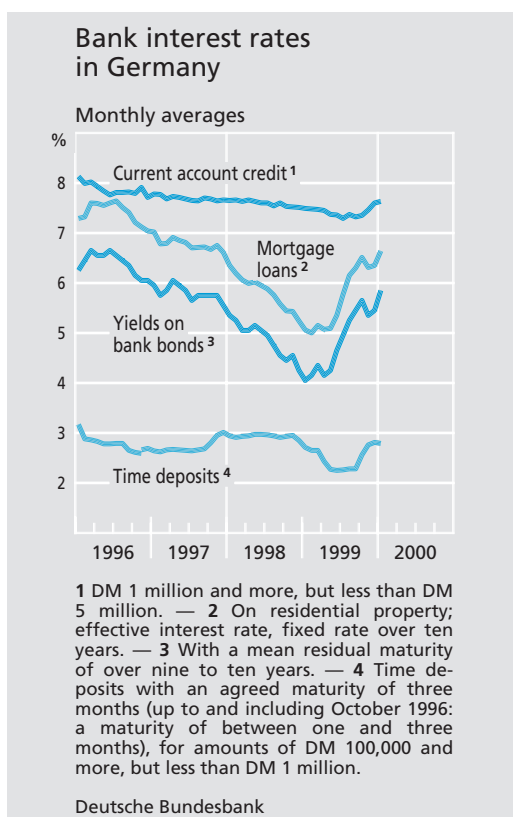
Bank interest rates likewise distinctly higher

In keeping with interest-rate movements in the bond market, long-term bank interest rates, too, have climbed perceptibly in recent months. This January, mortgage loans with interest rates locked in for ten years cost an average of roughly 6 $\frac{2}{3}$ %, against 6 $\frac{1}{3}$ % in September 1999. The effective rates for long-term fixed-rate loans to enterprises actually rose somewhat faster – viz. by almost one-half of a percentage point. In January, they averaged just over 6 $\frac{3}{4}$ % (for loans of between DM 200,000 and less than DM 1 million) and 6 $\frac{2}{3}$ % (for loans of DM 1 million to less than DM 10 million). In short-term banking business as well, interest rates were noticeably higher than in September last year, although deposit rates have tended to go up faster than the rates for short-term loans. For instance, the interest rate paid on time deposits with three-month maturities (deposits of DM 100,000 to less than DM 1 million) in January, at just over 2 $\frac{3}{4}$ %, was one-half of a percentage point higher than in September. By contrast, the interest rates charged for current account credit (e.g. for loans of DM 200,000 to less than DM 1 million) and for personal credit lines granted to private customers were raised less, namely by only one-quarter of a percentage point, or just under.



The above-mentioned fairly steep increase in yields at the short end of the bond market mainly reflects market players' expectations of rising central bank rates. The associated flattening-out of the yield curve is no indication of the pursuit of a restrictive monetary policy by the Eurosystem. Instead, the distinctly improved real earnings prospects are now being mirrored in the interest rates at the short end of the market, too, after only long-term capital-market rates had initially responded to the expected economic upswing. Hence the present flattening-out is consistent with the normal "breathing" of the term structure of interest rates during the business cycle. Moreover, short-term real interest rates have remained comparatively low, even after the twofold tightening of monetary policy by the Eurosystem. But the real and nominal

Interest-rate level comparatively low even after the raising of central bank rates



levels of long-term bond and bank interest rates are still affording the German economy favourable financing terms. In January the expected real capital-market rate for ten-year maturities (calculated on the basis of nominal yields, less the inflation expectations ascertained by means of surveys) stood at an estimated 4%; that is roughly consistent with the average of the nineties.

Equity prices

Booming equity market

There was a tempestuous upswing in the German equity market from the autumn onwards. As measured by the broad CDAX price index, quotations rose by 28% between the end of September and the end of the year. Whereas prices moved in step with the major

foreign equity markets in October and November, in the following months price movements detached themselves more and more from trends in the USA, where quotations stagnated under conditions of relatively high volatility. Towards the end of the year, the German market recorded substantially higher price gains than other European markets. Besides the improved growth prospects, this boom owed a great deal to the tax-reform plans announced towards the end of the year. The prices of bank and insurance company shares went up particularly fast; such prices benefited from the option included in the reform package of selling capital interests without becoming liable to tax. However, the highest price gains during the period under review were registered by shares from the technology and telecommunications sectors, which are mostly listed in the New Market, and which rose by around 60% each in the final quarter. At the beginning of the year 2000, the German equity market moved into choppier waters. Although prices once again reached record levels, the gains focused on an ever-smaller number of shares. There were also sharp drops in prices on several occasions. When this Report went to press in mid-February, the CDAX share-price index was just under 11% higher than at the end of 1999.

Fund-raising through the securities markets

Issuing activity in the German bond market slackened perceptibly towards the end of the year. Altogether, gross sales of bonds issued

Sales of bonds slacken towards the end of the year

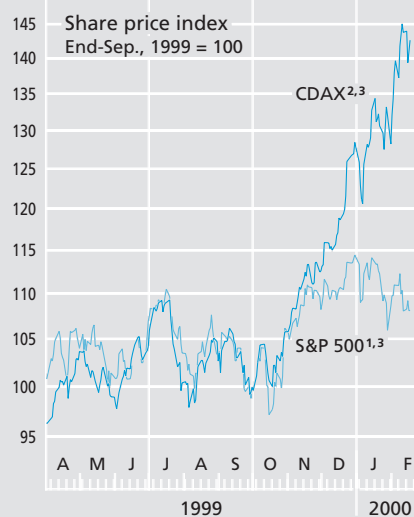
by domestic borrowers amounted to € 130 billion (market value) in the final quarter of 1999, compared with € 141 billion between July and September. Net sales after deduction of redemptions and after taking due account of changes in issuers' holdings of their own bonds, at € 27 billion, were actually less than one-half as large as those in the previous quarter (€ 58 ½ billion). This decline appears to have been due primarily to the spate of redemptions customary towards the end of a year, and less to any restraint in issuing ahead of the millennium change, since net sales were distinctly higher than in the final quarter of 1998 (€ 23 billion). Foreign bonds were sold to the value of € 10 ½ billion; the vast majority of them were denominated in euro, or in other currency units issued by EMU member states.

Reduced issuing activity of banks

The main cause of the decline in the amount raised in the bond market was the comparatively low net sales of bank debt securities, which, at € 17 billion in the last quarter of the year, were only about one-third as high as in the preceding quarter (€ 45 ½ billion). At the same time, there was a conspicuous shortening of maturities; whereas the outstanding amount of sub-one-year bank debt securities rose by € 22 ½ billion, medium- and long-term paper was redeemed on balance. That presumably owes much to investors' strong preference for liquid funds ahead of the millennium change. The public sector raised € 9 billion (net) through the bond market in the fourth quarter, compared with € 12 ½ billion in the third. The Federal Government increased its bonded debt by € 13 billion, primarily issuing ten-year bonds (€ 8 billion) and

Price movements in the equity market

Daily values, log. scale



1 Standard & Poors Corporate 500. — 2 Composite DAX. — 3 The two indices reflect the market-wide movement of prices in the US and German equity markets, respectively.

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five-year special Federal bonds (€ 6 billion). The net sales of Federal securities were accompanied by redemptions of paper issued by the Treuhand Agency and the former Federal Post Office (just over € 2 billion each). Bonds of industrial enterprises worth € 1 billion (net) were sold.

In the fourth quarter of 1999, domestic enterprises placed new shares to the value of € 6 ½ billion, compared with € 8 billion in the preceding quarter. Towards the end of the year, too, the trend towards "going public" was unabated. Between October and December, 39 German enterprises were listed for the first time on domestic stock markets. Sales of foreign equities ran at an exceptionally high level; between October and December they were bought by German residents to

Fund-raising in the equity market

Investment activity in the German securities markets

€ billion

Item	1999		1998
	July to Sep.	Oct. to Dec.	Oct. to Dec.
Bonds and notes			
Residents	38.8	7.3	27.6
Credit institutions 1	20.5	0.9	19.4
of which			
Foreign bonds and notes 2	12.7	7.3	20.1
Non-banks 3	18.3	6.4	8.1
of which			
Domestic bonds and notes	12.7	3.5	9.6
Non-residents 2	37.9	30.2	13.9
Shares			
Residents	21.0	25.1	25.3
Credit institutions 1	-0.7	11.1	1.7
of which			
Domestic shares	-1.5	6.5	3.6
Non-banks 3	21.7	14.0	23.6
of which			
Domestic shares	-0.3	-37.3	-18.7
Non-residents 2	9.9	37.3	19.5
Investment fund certificates			
Investment in specialised funds	7.7	22.7	20.0
Investment in funds open to the general public	9.5	4.7	4.2
of which: Share-based funds	3.9	5.6	2.8

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

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the extent of almost € 56 billion net (against just under € 23 billion in the third quarter). This is predominantly attributable to acquisitions of foreign equities in connection with corporate mergers.

Investment activity in the securities markets

Purchases of bonds

On the buyers' side of the bond market, foreign investors were in the forefront again in the final quarter of 1999. They bought domestic debt securities to the value of € 30 billion, compared with € 38 billion in the previous three months. About 80 % of the securities placed abroad were bank debt securities, the vast majority being short-dated paper. Domestic non-banks' demand for bonds

dropped sharply in the fourth quarter (€ 6 ½ billion, compared with € 18 ½ billion between July and September). Roughly two-thirds of this sum was accounted for by domestic bonds and one-third by foreign debt securities. In the closing months of 1999, credit institutions on balance bought next to nothing in the bond market. Their bond portfolios rose by no more than € 1 billion. That rise was associated with a switch from domestic bonds (- € 7 billion) to foreign debt securities (+ € 7 ½ billion).

On the buyers' side of the German equity market, too, foreign investors were to the fore in the fourth quarter of 1999; they invested € 37 ½ billion in German shares. Most of those transactions – as in the case of purchases of foreign shares by residents – were attributable to cross-border corporate mergers. The equity portfolios of domestic non-banks went up by € 14 billion. Credit institutions increased their holdings of equities by € 11 billion, after they had failed to buy any new shares on balance in the previous quarter.

Purchases of shares

The inflow of resources to domestic investment funds between October and December 1999, at € 27 ½ billion, was distinctly larger than in the preceding three months (€ 17 billion). However, only the specialised funds set up for institutional investors benefited from that rise; the amount accruing to them, at € 22 ½ billion, was almost three times as large as in the previous quarter (€ 7 ½ billion). This sizeable inflow mostly accrued to mixed funds and bond-based funds, which sold certificates worth € 11 billion net and € 9 billion

Investment fund certificates

net, respectively. By contrast, funds open to the general public received new capital amounting to € 4 ½ billion only; between July and September their receipts had totalled as much as € 9 ½ billion. Share-based funds continued to be the favourites; they received approximately € 5 ½ billion, followed by mixed funds and pension investment mutual funds (*Altersvorsorgefonds*) (€ 1 billion and € ½ billion, respectively). Money-market funds and bond-based funds, by contrast, had to repurchase certificates worth € 2 ½ billion and € 1 billion, respectively.

Deposit and lending business of monetary financial institutions (MFIs) with domestic customers

Sluggish trend in overnight deposits

In the deposit business of domestic MFIs, the seasonally adjusted overnight deposits of domestic investors were run down in the fourth quarter of 1999, after having grown strongly during the first three quarters of 1999. The decline was mostly concentrated in December, when enterprises repatriated far fewer funds from the Euromarket than they had in previous years, and households greatly enlarged their currency holdings in order to cope with difficulties expected in connection with the millennium change. In addition, the great buoyancy of Christmas trading no doubt also contributed to the sharp contraction of households' overnight deposits.

Shorter-term time deposits go up distinctly...

Moreover, during the fourth quarter some overnight deposits were apparently switched to shorter-term time deposits, which evidently became more attractive on interest-rate

Movement of the lending and deposits of monetary financial institutions (MFIs) in Germany *

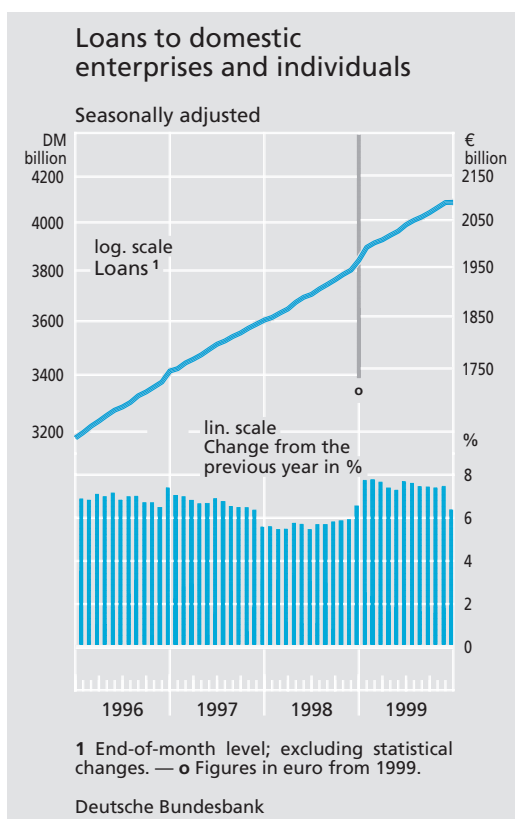
Item	€ billion	
	1999 Oct. to Dec.	1998 Oct. to Dec.
Deposits of domestic non-MFIs ¹	+ 14.8	+ 44.0
Overnight		
With agreed maturities		
up to 2 years	+ 19.8	+ 23.6
over 2 years ²	+ 10.5	- 5.6
At agreed notice ³		
up to 3 months	+ 4.8	+ 18.3
over 3 months ⁴	+ 1.6	+ 5.4
Lending		
Lending to domestic enterprises and individuals		
Loans	+ 40.2	+ 58.4
Lending against securities	+ 13.8	+ 20.5
Lending to domestic public authorities		
Loans	+ 6.2	+ 5.9
Lending against securities	- 1.5	- 9.2

* As well as banks (including building and loan associations, but excluding the Bundesbank), monetary financial institutions (MFIs) here also include money market funds; see also Table IV.1 in the Statistical Section of this Report. — ¹ Enterprises, individuals and public authorities. — ² In 1998 excluding, in 1999 including, deposits under savings and loan contracts. — ³ Savings deposits. — ⁴ In 1998 including, in 1999 excluding, deposits under savings and loan contracts.

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grounds. Deposits with agreed maturities of up to two years increased by € 19.8 billion, after having gone up only marginally in the previous quarter and having actually been reduced markedly in the second quarter. During the fourth quarter of 1999, the interest rates paid on three-month time deposits rose by one-half of a percentage point in connection with the end of the year and with the interest-rate increase by the ECB Governing Council on November 4. Deposits with an agreed maturity of over two years went up by € 10.5 billion between October and December, whereas they had declined by € 5.6 billion in the comparable period of the preceding year. Unlike the situation in the previous quarter, when the rise by € 7.5 billion had been entirely due to the demand of domestic insurance enterprises for such longer-term deposits,

... and longer-term ones rise quite strongly



employees were now likewise accumulating long-term time deposits again.

Slow growth of savings deposits at three months' notice

Deposits at agreed notice of up to three months rose by € 4.8 billion in the fourth quarter, and thus significantly more slowly than usual at that time of year. That presumably owes something not only to the slightly smaller amount of interest credited to savings accounts than in previous years, but above all to the distinctly slackening interest in higher-yielding special savings facilities, which in recent years have been almost solely responsible for the growth of deposits at agreed notice of up to three months. The reduction in longer-term savings deposits (those at agreed notice of over three months), which has been visible for years, persisted in the fourth quarter of 1999 after seasonal adjustment.

MFIs' lending to domestic enterprises and individuals in the period under review was somewhat weaker than in the two preceding quarters. While lending to the domestic private sector had increased at a seasonally adjusted annual rate of about 6½% at that time, in the fourth quarter of 1999 the pace of growth slowed to 5½%. It was primarily the expansion of loans to the domestic private sector that slackened further; seasonally adjusted and expressed as an annual rate, such growth amounted to 4½% between October and December. After seasonal adjustment, medium and long-term loans were less in demand than before, especially among self-employed persons. Short-term loans to domestic enterprises and individuals, which had been run down relatively strongly in the third quarter, continued to decrease slightly. However, the decline was confined to December. In the fourth quarter of 1999, domestic MFIs again strongly increased (by € 13.8 billion) their portfolios of securities issued by domestic enterprises, albeit rather less than in the third quarter. Where MFIs bought those securities in the secondary market, the purchases did not involve any flow of funds to private issuers.

Lending to the private sector more sluggish

Domestic general government debt to domestic MFIs increased by € 4.7 billion in the fourth quarter of 1999, compared with a decrease by € 3.3 billion one year earlier. These contrary trends were substantially due on balance to portfolio transactions by the MFIs, which ran down their holdings of domestic government bonds distinctly less in the last quarter of 1999 (by € 1.5 billion) than in preceding years. By contrast, loans to general

Public-sector debt slightly increased

government increased by € 6.2 billion in the fourth quarter of 1999, and thus by an amount similar to that recorded a year before (+€ 5.9 billion); the rise was entirely due to seasonal factors.