

## Financial markets in Germany

### Capital-market and bank interest rates

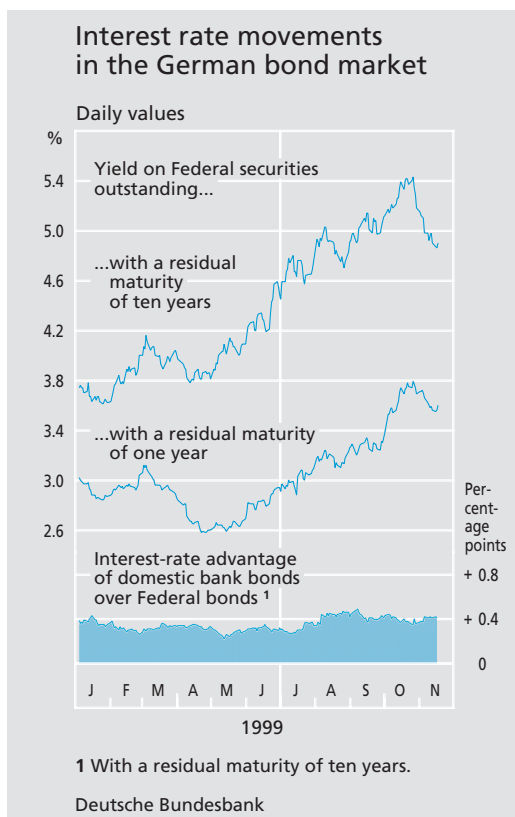
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German capital-market rates rose in the autumn, in line with yields in the other euro-area countries. The yield on ten-year Federal bonds outstanding increased by almost one percentage point to nearly 5½% between the end of June and the end of October. In the wake of the raising of interest rates by the Eurosystem, yields then dropped to less than 5%; they were still at that level when this Report went to press. Hence the yield on ten-year Federal bonds remains about one-quarter of a percentage point below the average of the euro area; the maximum yield advantage of some euro-area countries over Germany is still just under one-half of a percentage point. The interest rates on Federal securities with shorter residual maturities went up until the end of October, in line with the rise at the long end of the market, but declined only a little thereafter. The yield curve of Federal securities has thus flattened out most recently. In mid-November the gap discernible in the market between the interest rates on ten-year Federal paper and those on one-year paper was roughly 1½ percentage points, compared with more than 1¾ percentage points at times in the summer.

*Initially further rise in capital-market rates*

The interest-rate advantage of ten-year debt securities issued by domestic banks over comparable Federal bonds has been around 40 basis points in recent months; this is about ten basis points above the average of the first half of the year. The widening of the spread is probably mainly due to investors' pronounced liquidity preference in the run-up to the millennium change. As a consequence, bank

*Interest-rate spreads in the bond market relatively large in the run-up to the millennium date change*



debt securities, whose market is not as broad and deep as that of Federal bonds, and for which full hedging facilities through futures markets do not exist, are traded at a liquidity-risk premium. The interest-rate advantage of the sub-category "other bank debt securities" increased particularly markedly (latterly to over 50 basis points). For such typically relatively small issues, liquidity risks are more important than for mortgage bonds.

*Long-term bank interest rates higher, short-term interest rates virtually unchanged*

Long-term bank interest rates were raised in recent months, in line with the increase in bond-market yields. In October, mortgage loans with interest locked in for ten years cost 6½% on average, against 5½% in June 1999. The rates for long-term fixed-rate loans to enterprises changed to a similar extent; effective rates averaging 6⅔% were charged

in October (credit volume ranging from DM 200,000 to less than DM 1 million), or 6½% (credit volume ranging from DM 1 million to less than DM 10 million). The rates for housing loans and investment credit were thus most recently around one percentage point higher than in the early summer. Short-term deposit and lending rates, by contrast, remained largely unchanged until October. Only three-month time-deposit rates (DM 100,000 to less than DM 1 million) rose by almost one-third of a percentage point to an average of 2⅔% in October; this was mainly due to the liquidity premium payable for short-term funds not maturing until after the millennium change.

Even after the raising of central bank rates by the Eurosystem at the beginning of November, interest-rate conditions for the German economy continue to be favourable, especially as capital-market rates have declined again against the background of the interest-rate decision. The uncertainty associated with the millennium change has had only a minor impact on the yield curve, and thus gives no cause for concern. Nominal capital-market and bank interest rates are still at a very low level in historical terms. In real terms, too, the interest-rate level remains relatively low. The expected real capital-market rate for ten-year maturities (calculated on the basis of the nominal yields less the inflation expectations ascertained through surveys) was estimated at almost 3½% most recently, compared with an average of around 4% during the nineties.

*Interest-rate conditions favourable even after the raising of central bank rates*

## Share prices

*German equity market showing no clear price trend*

The German equity market has been marked by strong fluctuations in recent months, but initially showed no clear price trend; at the end of October prices went up more rapidly, to reach new record levels for the year most recently. Prices were bolstered by improved cyclical and growth prospects for the German economy. Numerous speculations on mergers and acquisitions in the corporate sector probably had similar effects. The focus here was on telecommunication and financial enterprises, whose shares (which are included in the CDAX) registered large price gains between the end of July and mid-November (+ 30 ½ % and + 18 %, respectively, compared with + 12 % for the market as a whole). The distinct rise in capital-market rates exerted a price-dampening impact until the end of October. Another significant factor was the prolonged absence of positive trends in the US equity market. In mid-November German share prices – as measured by the comprehensive CDAX index – were about 3 % above the previous peak for the year, reached in mid-July. That represents a rise of 14 % compared with the end-1998 level, but still a 7 % decline from the record high of July 1998.

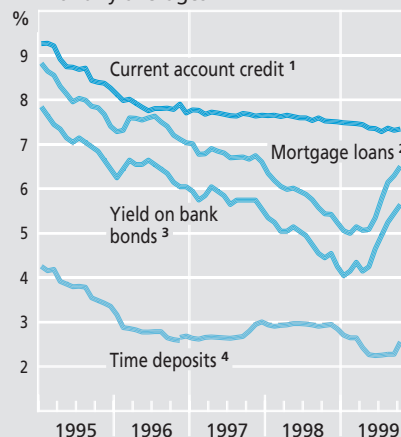
## Borrowing in the securities markets

*Sales of bonds continue strong*

Issuing activity in the German bond market remained at a relatively high level in the third quarter. Gross sales of bonds issued by German borrowers amounted to € 141 billion (market value), compared with € 133 ½ bil-

## Bank interest rates in Germany

Monthly averages

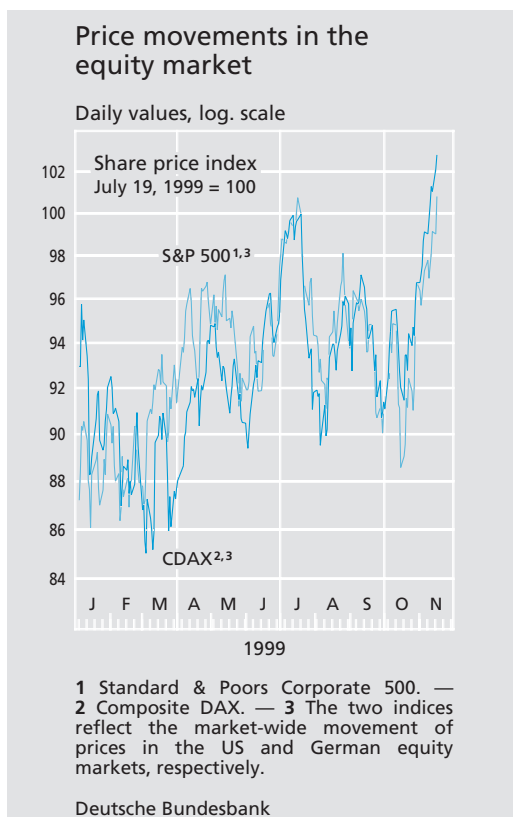


1 DM 1 million and more, but less than DM 5 million. — 2 On residential property; effective interest rate, fixed rate over ten years. — 3 With a mean residual maturity of over nine to ten years. — 4 Time deposits with an agreed maturity of three months (up to and including October 1996: a maturity of between one and three months), for amounts of DM 100,000 and more, but less than DM 1 million.

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lion in the second quarter and a record € 163 ½ billion in the first quarter. Over three-quarters of the amount of newly issued paper was denominated in euro. Net of redemptions and after taking due account of the changes in issuers' own portfolios, sales of domestic bonds and notes yielded € 58 ½ billion between July and September, compared with € 50 billion in the three preceding months. Issues from Germany accounted for about one-third of the net sales of bonds in the euro area as a whole (in the first seven months of this year). € 18 ½ billion (net) of foreign bonds were sold; almost all of such paper was denominated in euro, or other currency units of euro-area countries.

The increase in bond-market borrowing is due to the more buoyant public sector issuing



*Buoyant public  
sector issuing  
activity*

activity. The public sector issued € 12 ½ billion (net) of debt securities, compared with only € 3 ½ billion in the second quarter. The Federal Government increased its bond-market debt by € 18 ½ billion, issuing primarily ten-year bonds (to a nominal amount of € 16 ½ billion). This figure also includes borrowing by Federal special funds, which for some time have been issuing in the bond market in the name of the Federal Government. The large net sales of Federal securities were accompanied by redemptions of paper issued by public borrowers which – like the Treuhand Agency – no longer figure as issuers. Domestic credit institutions received € 45 ½ billion from sales of their own debt securities between July and September, and thus virtually the same amount as in the previous quarter. Banks stepped up their issues of short-term

paper; that presumably owes much to investors' aforementioned strong liquidity preference in the run-up to the millennium change.

Domestic enterprises placed about € 8 billion of new shares in the third quarter of 1999. This amount is distinctly lower than the issue volume in the previous quarter (€ 18 billion), which, however, was determined by the capital increase of Deutsche Telekom. The number of new issues, on the other hand, remained high. In the third quarter, 45 enterprises decided to have their shares listed on a German stock exchange. At 129, the number of stock exchange listings in the first nine months of this year is already almost twice as high as in the whole of 1998. The new market was well to the fore, attracting 98 new issues. Interest in foreign shares remained unabated. Between July and September, almost € 23 billion (net) of foreign equities were sold in Germany (against nearly € 16 billion in the previous quarter), with the great bulk being accounted for by portfolio investment.

*Lower  
borrowing in  
the equity  
market*

### Investment activity in the securities markets

Non-residents were the principal buyers in the bond market in the third quarter. They purchased € 38 billion (net) of domestic debt securities, compared with € 26 ½ billion in the three preceding months. Over two-thirds of the paper placed abroad consisted of bank bonds. Especially in September, when interest-rate uncertainty in the capital market increased, non-residents preferred short-dated

*Purchases of  
bonds and  
notes*

bank paper, while selling long-dated public bonds on a major scale (– € 6 billion). Domestic non-banks slightly stepped up their bond purchases in the third quarter. They bought € 18 billion of bonds (April to June: € 14 ½ billion). € 12 ½ billion of that amount was accounted for by domestic debt securities, the vast bulk of which were issues by credit institutions. Banks increased their bond portfolios by € 20 ½ billion.

*Shares*

Domestic non-banks once again dominated the buyers' side of the German equity market in the third quarter; they bought equities to the value of € 21 ½ billion net. However, almost all of such paper was made up of foreign equities (€ 22 billion). Foreign investors continued to show a keen interest in German shares. They added € 10 billion to their portfolios of domestic equities, compared with € 21 ½ billion in the preceding three-month period. Domestic credit institutions, by contrast, sold a small amount of shares (– € ½ billion net) after having reduced their equity portfolios by € 13 ½ billion between April and June.

*Investment  
fund certificates*

The amount accruing to domestic investment funds between July and September, at € 17 billion, was about one-quarter below the level of the previous quarter (€ 24 billion). All of this decline was accounted for by the specialised funds held by institutional investors, inflows to which amounted to only € 7 ½ billion (April to June: € 14 ½ billion). At the same time, insurance enterprises, in particular, placed major amounts of funds direct with banks again in the third quarter. Funds open to the general public received (as be-

### Investment activity in the German securities markets

Item	1999	
	Apr. to June	July to Sep.
<b>€ billion</b>		
<b>Bonds and notes</b>		
Residents	52.1	38.7
Credit institutions <sup>1</sup>	37.4	20.5
of which		
Foreign bonds and notes <sup>2</sup>	19.2	12.7
Non-banks <sup>3</sup>	14.7	18.2
of which		
Domestic bonds and notes	5.5	12.6
Non-residents <sup>2</sup>	26.5	38.0
<b>Shares</b>		
Residents	12.4	21.0
Credit institutions <sup>1</sup>	– 13.7	– 0.6
of which		
Domestic shares	– 16.0	– 1.5
Non-banks <sup>3</sup>	26.1	21.7
of which		
Domestic shares	12.7	– 0.3
Non-residents <sup>2</sup>	21.6	9.9
<b>Investment fund certificates</b>		
Investment in specialised funds	14.3	7.7
Investment in funds open to the general public	9.6	9.5
of which: Share-based funds	3.2	3.9

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

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fore) € 9 ½ billion. The general public continued to show a preference for share-based funds, to which about € 4 billion accrued, followed by money market funds and open-end real estate funds (€ 1.7 billion and € 1.5 billion, respectively).

### Deposit and lending business of Monetary Financial Institutions (MFIs) with domestic customers

In domestic MFIs' deposit business, domestic investors' overnight deposits continued to expand strongly in the third quarter. At a seasonally adjusted annual rate of just under 9%, however, they grew much more slowly than in the two preceding quarters (21 ½% in the second quarter and 29 ½% in the first).

*Liquidity preference remains fairly strong*

### Trends in the lending and deposits of Monetary Financial Institutions (MFIs) in Germany \*

€ billion

Item	July to Sep. 1999	July to Sep. 1998
Deposits of domestic non-MFIs 1		
Overnight	+ 3.4	+ 5.9
With an agreed maturity of up to two years	+ 0.9	+ 2.4
of more than two years 2	+ 7.5	+ 2.8
Redeemable at notice 3		
of up to three months	- 3.8	- 0.5
of more than three months 4	- 2.2	- 2.7
Lending		
Lending to domestic enterprises and individuals		
Loans	+ 23.3	+ 27.7
Lending against securities	+ 3.5	- 2.1
Lending to domestic public authorities		
Loans	- 1.1	+ 4.8
Lending against securities	+ 1.3	- 11.0

\* Besides banks (including building and loan associations), Monetary Financial Institutions (MFIs) also include money market funds; see also Table IV.1 in the Statistical Section of the Monthly Report. — 1 Enterprises, individuals and public authorities. — 2 In 1998 excluding deposits under savings contracts with building and loan associations, in 1999 including such deposits. — 3 Savings deposits. — 4 In 1998 including deposits under savings contracts with building and loan associations, in 1999 excluding such deposits.

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That probably owed something to the sharp decline in repatriations of funds hitherto held in the euro market. Whereas such funds were re-transferred to Germany on a major scale in the first half of the year, they hardly declined any further in the third quarter. The rise in long-term interest rates and the associated pronounced interest-rate uncertainty may, however, have encouraged the liquidity preference.

*Shorter-term time deposits ...*

Deposits with an agreed maturity of up to two years, which had been reduced massively in the previous quarter (-€ 12.0 billion), were built up slightly again in the third quarter (+€ 0.9 billion). The reason why they did not benefit more from the prevailing interest-rate uncertainty was probably that banks left short-term time-deposit rates (maturity: up to

three months), after having lowered them in the spring, virtually unchanged in the third quarter, so that there was practically no change in their attractiveness compared with other deposits. Deposits at an agreed maturity of over two years, by contrast, grew by € 7.5 billion in the same period, compared with € 2.8 billion a year earlier. The sharp increase was on balance entirely due to domestic insurance enterprises' heavier demand for such longer-term deposits. Whether this is an initial indication of a revival of interest in longer-term bank deposits on interest-rate grounds still remains to be seen. In the past, however, domestic insurance enterprises tended to seek to replace such deposits by other assets. Deposits at an agreed period of notice of up to three months grew distinctly more slowly in the period under review – at a seasonally adjusted annual rate of 2½% – than in the previous quarter. In contrast to this, the run-down of longer-term savings deposits (with an agreed period of notice of over three months) apparent for a long time slowed down again compared with the second quarter.

*... and longer-term time deposits built up*

*Savings deposits at three months' notice grow moderately*

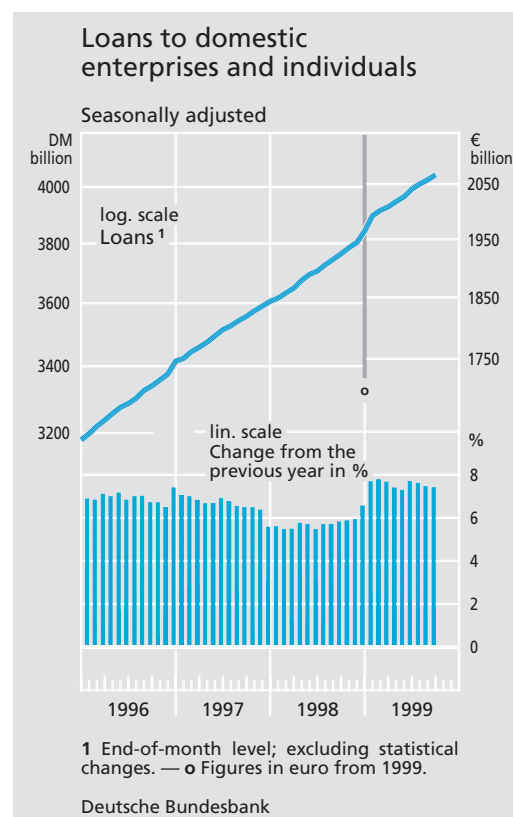
MFI lending to domestic enterprises and individuals, which had slackened in the second quarter after the sharp rise around the turn of the year, remained at roughly the level reached in the third quarter. Private sector debt went up by € 26.8 billion between July and September. Seasonally adjusted and expressed as an annual rate, this was an increase of 6½%. Compared with the first quarter (just over 10%) this represented a general normalisation. That applies in particular to loans to the private sector, which, at a

*Lending to the private sector more or less unchanged*

seasonally adjusted annual rate of almost 5½%, once again grew more slowly than in the preceding quarter (6½%). Overall, lending is now probably largely in keeping with the present cyclical situation. In the period under review, private non-banks reduced their short-term loans while expanding their medium and long-term borrowing slightly more rapidly than in the previous quarter. Employed persons, in particular, tried to lock in borrowed funds at relatively low rates at longer term in view of the rising longer-term interest rates. MFIs increased their portfolios of securities issued by the domestic corporate sector by € 3.5 billion in the third quarter. In the previous quarter they had sold such paper to the amount of € 5.2 billion on account of maturing forward transactions. Seasonally adjusted and expressed as an annual rate, German MFIs' lending to domestic enterprises against securities went up by 18% in the third quarter. However, such lending accounts for less than 10% of total MFI lending to the domestic private sector.

*Public sector  
debt unchanged*

Domestic public sector debt to domestic MFIs remained almost unchanged in the period under review, whereas a year earlier it had



declined by € 6.2 billion. Specifically, loans dropped by € 1.1 billion, while MFI holdings of domestic government bonds rose by € 1.3 billion. To the extent that this rise was due to purchases in the secondary market, it does not imply any corresponding inflow of funds to public sector issuers.

