

Financial markets in Germany

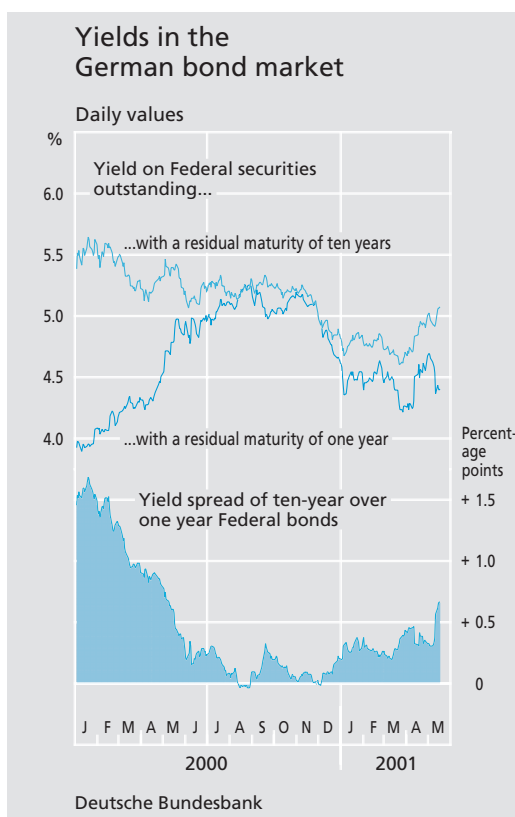
Capital market and bank interest rates

In March the yield on ten-year Federal bonds outstanding, which had edged sideways at the start of the year, fell by $\frac{1}{4}$ percentage point to just over $4\frac{1}{2}\%$. It subsequently picked up again and in mid-May, at the time of going to press, it was around 5%. On balance, long-term capital market rates in Germany rose by just over $\frac{1}{4}$ percentage point from mid-February to mid-May. By contrast, interest rates on Federal securities with a shorter residual maturity went down. The spread of interest rates on Federal securities with different maturities has therefore broadened and the estimated yield curve is again somewhat steeper. In mid-May the yield spread of ten-year Federal bonds, as observed on the market, over one-year paper was $\frac{2}{3}$ percentage point, compared with less than $\frac{1}{4}$ percentage point in mid-February. The convergence of German capital market rates with the yields in the other euro-area countries diminished slightly in spring. At the time of going to press, the yield of ten-year Federal bonds was just under $\frac{1}{3}$ percentage point below the euro-area average (excluding Germany).

Slight interest rate increase on the capital market

The interest rate spread between ten-year debt securities issued by domestic banks and comparable Federal bonds has been narrowing somewhat since mid-February. At around $\frac{1}{2}$ percentage point, it is at roughly the same level as one year ago. Having reached a record level of over 120 basis points in March, the yield spread of domestic corporate bonds over public debt instruments has also fallen back to prior-year levels of around 80 basis points at the current juncture.

Risk spreads on the bond market slightly reduced



Steeper yield curve

Although the overall yield curve became steeper as interest rates rose from mid-March onwards, it was still inverse for one-year bonds. This continues to indicate that interest rates are expected to go down at the short end, even though the anticipation of this happening has subsided somewhat. With regard to longer-term securities, surveys reveal a slight increase in long-term inflation expectations. This explains why the expected real capital market rate for ten-year bonds (calculated on the basis of nominal yields less the inflation expectations determined in surveys) did not go up despite an increase in nominal yields. It was just over 3% in April, compared with around 4% on average in the 1990s.

Long-term bank interest rates have so far not kept in line with the interest rate increase on

the capital markets. On balance the rates for long-term loans by credit institutions in Germany fell in recent months by roughly $\frac{1}{8}$ percentage point. In April this year, the interest rate charged on mortgage loans with interest locked in for ten years was, on average, around $6\frac{1}{8}\%$, following $6\frac{1}{4}\%$ in January 2001. In April the average effective rates for long-term fixed-rate loans to enterprises were $6\frac{3}{4}\%$ (for a credit volume of between DM 200,000 and less than DM 1 million) and $6\frac{1}{2}\%$ (for a credit volume of between DM 1 million and less than DM 10 million). In short-term banking business, interest rates for current account credit (for a credit volume of between DM 1 million and less than DM 5 million) fell by $\frac{1}{4}$ percentage point to just over $8\frac{3}{4}\%$ and the interest rate on three-month time deposits (for an investment volume of DM 100,000 to less than DM 1 million) was, at just under 4%, somewhat lower in April than in January. However, the rates for personal credit lines and for higher-yielding retail sight deposits were raised slightly.

No turnaround in long-term bank interest rates

Share prices

In the first quarter of this year, the prices of German shares initially continued to fall, with wide fluctuations, following the pattern begun in spring 2000. Compared with their peak in March 2000, German share prices, as measured on the broad CDAX share price index, fell year on year by around 37%. However, from early April prices generally began to go up again. The situation on the German equity market relaxed again somewhat, in line with the situation on the equity markets

Recovery on the equity markets

in other European countries and the United States. This is also indicated by the decline in implied volatility since the start of the year, as measured on the VDAX.

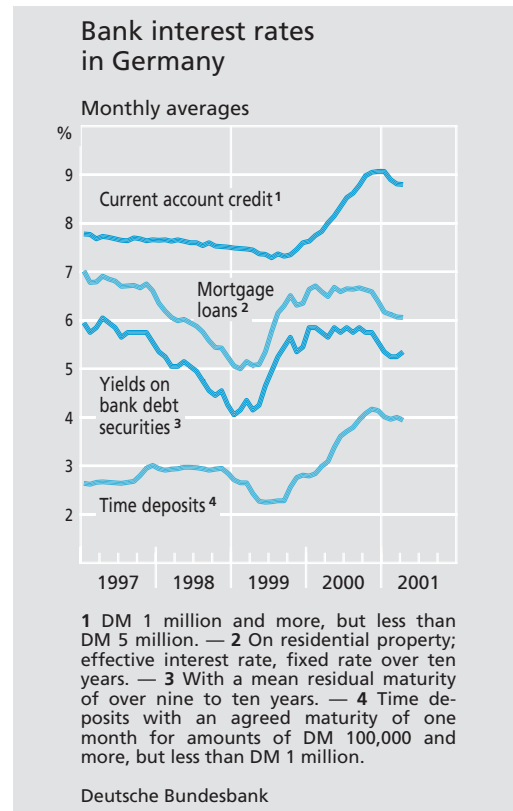
TMT share prices rising again

Share prices of firms in the technology, media and telecommunications (TMT) sector, in particular, have been going up since the start of April. After sliding by almost 70 % from their peak in March 2000 to the end of March this year, these prices went up by more than 23 % in April alone.¹

Borrowing in the securities markets

Increased sales of bonds and notes at the start of the year

Issuing activity on the German bond market gained momentum again at the start of the year. In the first three months of 2001, gross sales of bonds and notes issued by domestic borrowers amounted to € 216.1 billion, compared with € 193.7 billion in the previous quarter. However, extensive redemptions, especially by public authorities, led to net sales of domestic fixed-interest securities (taking account of the changes in issuers' holdings of their own bonds) being, at € 20.7 billion, no higher from January to March than in the previous quarter. By contrast, purchasing of foreign bonds and notes by residents was stronger. On balance, between January and March € 32.0 billion worth were sold in Germany, compared with € 13.3 billion in the fourth quarter of 2000. All of these bonds and notes were denominated in euro. Sales of debt securities on the German bond market as a whole consequently amounted to € 52.7 billion net in the first three months of

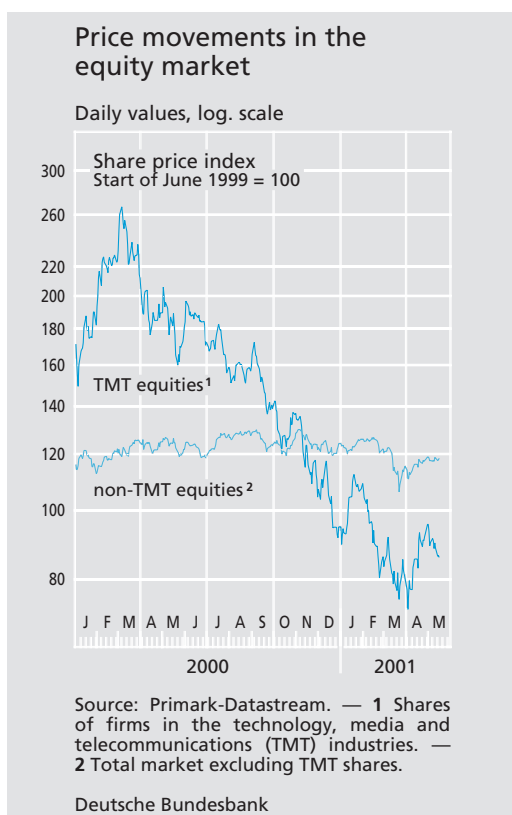


2001. This was considerably up on the previous quarter (€ 33.9 billion).

Increased borrowing can be traced back in part to the increase in issuing activity by banks. They issued € 36.3 billion net worth of their own debt securities, compared with no more than € 7.4 billion worth in the preceding three months. The bulk of these were other bank debt securities, which amounted to € 20.4 billion. Communal bonds (*Öffentliche Pfandbriefe*) were sold for € 6.7 billion net; in the previous quarter their outstanding amount had gone down by € 11.9 billion. However, larger volumes of debt securities issued by specialised credit institutions (€ 5.7 billion) and mortgage bonds (*Hypothekendarlehen*)

Lively issuing activity by banks

¹ Measured on Primark-Datastream's TMT sector index.



briefe) (€ 3.4 billion) were issued. Public authorities redeemed debt securities in the amount of € 20.8 billion net, after borrowing € 11.7 billion in the three previous months. Net redemptions can essentially be traced back to the redemption in January of debt securities issued by the Currency Conversion Equalisation Fund. By contrast, the Federal Government issued € 15.0 billion net worth of new securities and the Länder issued € 3.5 billion worth of debt securities. Industrial bonds were sold for € 5.1 billion net, which represents a significant increase compared with the previous quarter and the comparable period of the previous year.

In the first quarter of 2001 domestic enterprises placed new shares to a market value of € 4.1 billion, virtually the same amount as in

the previous quarter. However, the number of initial public offerings by domestic enterprises continued to fall – to nine new IPOs from 24 in autumn 2000. The sale of foreign equities amounted to € 7.3 billion net, with portfolio investment accounting for one-half and direct investment for the other.

Investment activity in the securities markets

Domestic non-banks were the principal buyers on the bond market in the first quarter of 2001, increasing their bond holdings by € 37.2 billion. Roughly two-thirds of this amount was invested in domestic debt securities and one-third in foreign bonds. Domestic credit institutions purchased, on balance, € 22.8 billion worth of bonds and notes, mainly bank debt securities (€ 19.0 billion) and foreign bonds and notes (€ 17.5 billion). Stocks of public bonds decreased on balance by € 12.9 billion. At the start of the year non-residents sold € 7.3 billion net worth of German debt securities, after adding € 7.9 billion worth of German securities to their portfolios in the previous quarter. This disinvestment is due solely to a decline in public sector securities (– € 11.6 billion).

Purchases of bonds

At the start of the year domestic credit institutions took a lively interest in German shares. In the first quarter they increased their domestic equity holdings by € 23.3, compared with € 5.2 billion in the previous quarter. All in all they acquired € 29.8 billion net worth of equities. By contrast, domestic non-banks reduced their equity holdings by € 26.7

Shares

billion, selling on balance domestic shares only. In the first quarter of 2001, non-resident investors purchased German equities in the amount of € 8.3 billion (net).

*Investment
fund certifi-
cates*

From January to March domestic investment funds raised, at € 24.3 billion, approximately as large an amount as in the previous quarter (€ 25.6 billion). In contrast to the previous three months, funds open to the general public increased their sales again, issuing € 12.1 billion net worth of certificates (previous quarter: € 7.7 billion). Specialised investment funds raised € 12.2 billion net, compared with € 17.9 billion at the end of 2000. The increase in inflows to funds open to the general public is accounted for by open-end real estate funds and money market funds; these raised € 3.2 billion and € 2.9 billion respectively. In contrast to the previous quarter, share-based funds raised a smaller amount (€ 2.8 billion). In the case of specialised investment funds, mixed funds attracted the largest inflow of resources, with net sales in the amount of € 8.7 billion.

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

*Clear increase
in overnight
deposits*

In seasonally adjusted terms, the overnight deposits of domestic customers with German MFIs increased strongly in the first quarter of 2001. As in the previous year, the clear scaling-down of sight deposits, which tends to occur at this time of year, failed to take place in the review period. In particular, domestic households, as well as other financial

Investment activity in the German securities markets

€ billion			
Item	2000	2001	2000
	Oct. to Dec.	Jan. to Mar.	Jan. to Mar.
Bonds and notes			
Residents	26.0	60.0	70.3
Credit institutions ¹	11.8	22.8	37.9
of which			
Foreign bonds and notes ²	11.2	17.5	12.8
Non-banks	14.2	37.2	32.4
of which			
Domestic bonds and notes	12.1	22.7	18.3
Non-residents ²	7.9	- 7.3	5.8
Shares			
Residents	136.8	3.0	- 6.5
Credit institutions ¹	8.2	29.8	45.8
of which			
Domestic shares	5.2	23.3	43.0
Non-banks ³	128.6	- 26.7	- 52.3
of which			
Domestic shares	135.8	- 27.5	- 100.2
Non-residents ²	- 136.8	8.3	62.3
Investment fund certificates			
Investment in specialised funds	17.9	12.2	9.5
Investment in funds open to the general public	7.7	12.1	16.3
of which: Share-based funds	7.6	2.8	12.9

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

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institutions, increased their holdings of sight deposits – probably as a reaction to the falling prices on the equity markets. In addition, the drop in interest rates which occurred during the quarter is also likely to have contributed to the accumulation of these liquid money components that bear little or no interest.

Short-term time deposits also benefited from the preference shown by domestic investors for liquid forms of investment. They went up in the first quarter of 2001 by € 7.3 billion, having been reduced by € 7.7 billion over the same period one year previously. Primarily individuals – and to a lesser extent insurance companies, too – increased their holdings of this type of deposits. Longer-term time deposits, however, were subject to a far smaller expansion. Compared with an increase of

*Perceptible
increase in
short-term time
deposits ...*

*... and
moderate
increase in
longer-term
time deposits*

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

€ billion

Item	2001	2000
	Jan. to Mar.	Jan. to Mar.
Deposits of domestic non-MFIs ¹		
Overnight	- 2.2	+ 6.1
With agreed maturities		
up to 2 years	+ 7.3	- 7.7
over 2 years	+ 1.8	+ 5.2
At agreed notice ²		
up to 3 months	- 7.4	- 15.5
over 3 months	- 0.5	+ 0.9
Lending		
Lending to domestic enterprises and individuals		
Loans	+ 16.7	+ 21.4
Lending against securities	+ 24.4	+ 37.7
Lending to domestic public authorities		
Loans	+ 4.0	- 1.3
Lending against securities	- 12.9	+ 3.9

* 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 Savings deposits.

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€ 5.2 billion a year before, they rose by only € 1.8 billion in the first quarter of this year. In particular, insurance companies, which traditionally represent the largest group of investors, accumulated only relatively few new longer-term time deposits in the period under review.

Further fall in savings deposits with an agreed period of notice

The decrease of deposits with an agreed period of notice of up to three months continued during the period under review. However, the decline was more moderate than one year previously. From January to March 2001 domestic non-banks reduced their short-term savings deposits by € 7.4 billion. In the same period one year earlier they had reduced their holdings by € 15.5 billion. Although, in particular, traditional savings deposits with an agreed period of notice of up

to three months declined again in the period under review, households also reduced their holdings of special savings facilities attracting a higher rate of interest. In contrast to the previous quarters, savings deposits with longer agreed periods of notice were unable to derive any noticeable benefit from the decrease in short-term savings deposits. The funds released are therefore likely to have flowed mainly into time deposits.

After weak growth in the previous quarter, lending by German MFIs to domestic enterprises and individuals picked up perceptibly in the first quarter of 2001. Loans and lending against securities were equally affected. Having plummeted to ½ % in the last quarter of 2000, the seasonally adjusted annual increase in loans was just under 6 % in the first quarter of 2001. Loans were boosted mainly by a marked increase in short-term debts of domestic enterprises and households. By contrast, there was only a moderate expansion of medium and long-term loans.

Clear expansion of lending to the private sector...

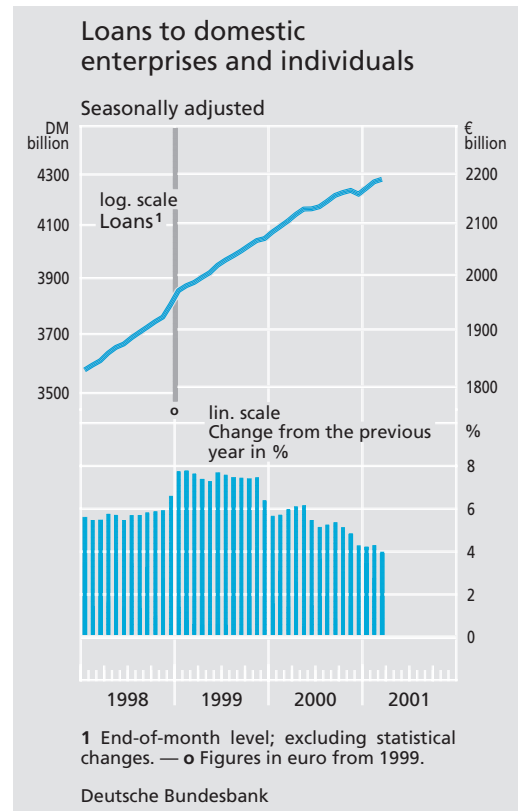
With regard to the most important categories of borrowers, borrowing by enterprises, in particular, increased strongly in the first quarter of 2001, after these had reduced their debt to domestic MFIs in seasonally adjusted terms in the final quarter of 2001. There was also some recovery in housing loans in the quarter under review, whereas employees reduced their loans from domestic MFIs. Within the enterprise sector there was a distinctly stronger demand for credit in the services sector and the wholesale and retail trade and from financial institutions – although, in the case of financial institutions, a particular im-

... and especially to enterprises

pact was made by larger single transactions. By contrast, the moderate pace of expansion maintained by manufacturing in the previous quarters continued.

*Decline in
public sector
debt*

The level of indebtedness of German public authorities to domestic MFIs fell by € 8.9 billion in the first quarter of 2001. Loans by German MFIs to the domestic public sector went up by € 4.0 billion, while the liabilities evidenced by certificates of domestic public authorities to German banks were reduced by € 12.9 billion. This decrease was due to the redemption of equalisation claims by the Federal Government totalling € 33 billion at the start of the year. Of this redemption volume, € 28.4 billion went to German MFIs, at least some of which, however, increased their holdings of government debt again by acquiring domestic government bonds in the secondary market. In order to finance the redemption, the government drew on the proceeds of the sale of UMTS mobile phone licences, which it was holding mainly as



deposits in the German banking sector. These were reduced strongly in the period under review.