

Financial markets in Germany

Capital market and bank interest rates

From mid-November to early January long-term capital market interest rates fell to $4\frac{2}{3}\%$. The yield on ten-year Federal bonds outstanding subsequently rose somewhat and at the time of going to press it was, at $4\frac{3}{4}$ percentage points, around $\frac{1}{2}$ percentage point up on the level in autumn last year. During the same period, interest rates on Federal securities with a shorter residual maturity, which are influenced more strongly by changing conditions in the money market, fell by $\frac{2}{3}$ percentage point. The yield curve on the German bond market has therefore again become somewhat steeper. In mid-February the spread of interest rates between ten-year and one-year Federal bonds (observed values) was just over $\frac{1}{4}$ percentage point, having fallen considerably during the fourth quarter of 2000 and having even become negative for a short period in early December. In winter, yields in the other euro-area countries once again evolved far more closely in line with German capital market rates than had previously been the case. In the period under review the yield differential compared with the German benchmark bonds remained relatively constant at just over $\frac{1}{4}$ percentage point.

Steeper ascent of the yield curve caused by a more marked decrease at the short end

Although the interest rate spread between ten-year debt securities issued by domestic banks and comparable Federal bonds recently narrowed slightly, it was still fairly large. In mid-February it was 54 basis points – 10 basis points more than one year ago. Overall, the yields on private bonds moved in line with the “more secure” government securities.

Risk spreads on the bond market still high

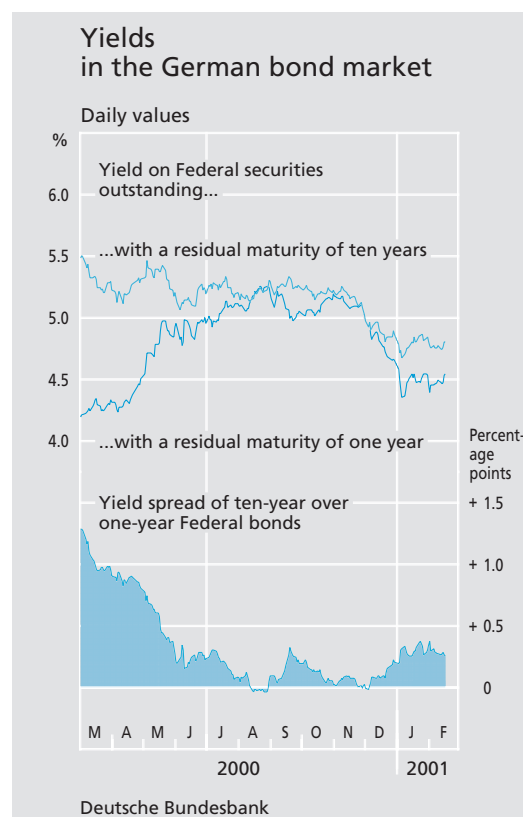
There is thus no indication of an increase in risk premiums.

Marked fall in short-term interest rates reflects expectations of a cut in central bank rates

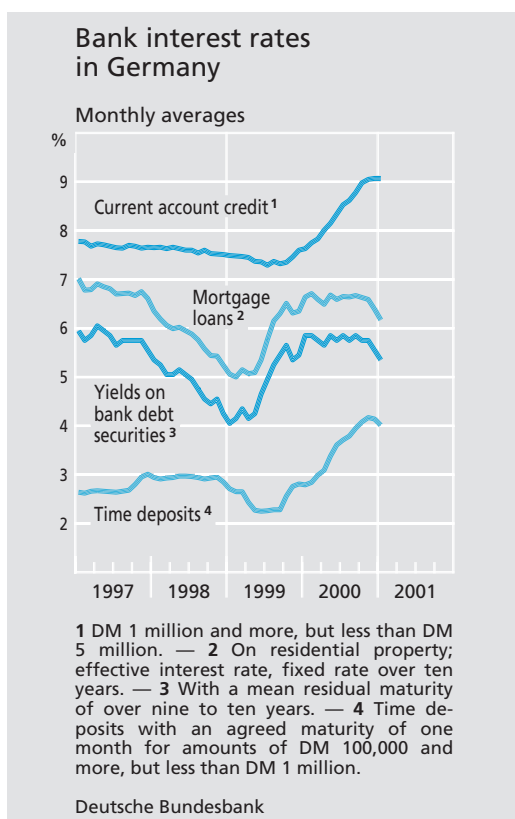
The marked decrease in yields at the short end of the bond market mainly reflects market players' expectations of a cut in central bank interest rates. This is accompanied by an inverse interest rate structure for one to two-year bonds. By contrast, for medium and long-term bonds the yield curve shows an upward slope. This pattern is an indication that expectations of a slowdown in economic activity related to speculations about a fall in interest rates are significant in the short term only and not in the long term. However, the upward movement for longer-term yields does not point to higher long-term inflation expectations. In fact, according to the information derived from surveys and financial market prices (such as the prices of index-linked as opposed to non-index-linked bonds), these expectations are currently (at approximately 1½%) rather low. Based on inflation expectations as indicated in the surveys, the expected real capital market rate for ten-year bonds was 3½% in January, as compared with around 4% on average in the 1990s. The financing terms of German business thus continue to be favourable over the long term.

Decline in long-term bank interest rates

In line with interest rate movements on the bond market, long-term bank interest rates have decreased in recent months. In January this year mortgage loans with interest locked in for ten years cost on average around 6¼%, following 6¾% in September 2000. The effective rates for long-term fixed-rate loans to enterprises dipped a little less – by just over ⅓ percentage point. In January they



were on average just under 7% (for a credit volume of DM 200,000 to less than DM 1 million) or 6⅔% (for a credit volume of DM 1 million to less than DM 10 million). In short-term banking business, however, interest rates were higher than in autumn last year, with rates for short-term lending increasing slightly more markedly than deposit rates. The interest rates for both current account credit (for a credit volume of DM 1 million to less than DM 5 million) and personal credit lines were raised by around ⅓ percentage point. However, at over 4%, the interest rate on three-month time deposits (for an investment volume of DM 100,000 to less than DM 1 million) was only a few basis points higher in January than in September.



Share prices

Share prices follow the development in the USA

On the German equity market prices fell markedly up to the end of December; since early January they have been rising again. Nonetheless, measured on the broad CDAX share price index, they were 7 % lower in mid-February than in mid-November and 25 % lower than at the peak in March 2000. The German market has tended to follow price movements in the USA more closely than the other European markets; in the USA the S&P 500 index rose slightly against a backdrop of an easing of US monetary policy, gaining 3 % from early January. Since the start of the new year share price volatility in Germany has also decreased again. The VDAX index, which indicates the implicit volatility of the futures contract due to mature

next on the DAX, fell back by 23 % overall in the period under review after a temporary increase in December.

In recent months the individual segments of the German equity market developed differently. The share prices of firms in the technology, media and telecommunications (TMT) industries, which are mostly listed on the *Neuer Markt*, experienced a loss in value of 27 % between mid-November and early 2001.¹ Marked fluctuations in share prices were also observed on the *Neuer Markt* as a whole. The NEMAX-All-Share price index, which comprises all equities traded on the *Neuer Markt*, was recently trading 70 % below its peak of March 10, 2000.

High volatility in TMT equities

Borrowing in the securities markets

Issuing activity on the German bond market slackened towards the end of the year. Overall, gross sales of bonds and notes issued by domestic borrowers in the final quarter of 2000 amounted to € 193.7 billion, compared with € 183.9 billion from July to September 2000. After subtracting redemptions and taking account of the changes in issuers' holdings of their own bonds, net bond sales were, at € 20.6 billion, distinctly lower than in the previous quarter (€ 38.3 billion). Net sales of foreign debt securities – at € 14.6 billion – were also down on the third quarter (€ 21.6 billion). As was previously the case, purchases by German investors were almost exclusively

Weaker sales of bonds and notes at the end of the year

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

of foreign debt securities denominated in euro (€ 12.6 billion).

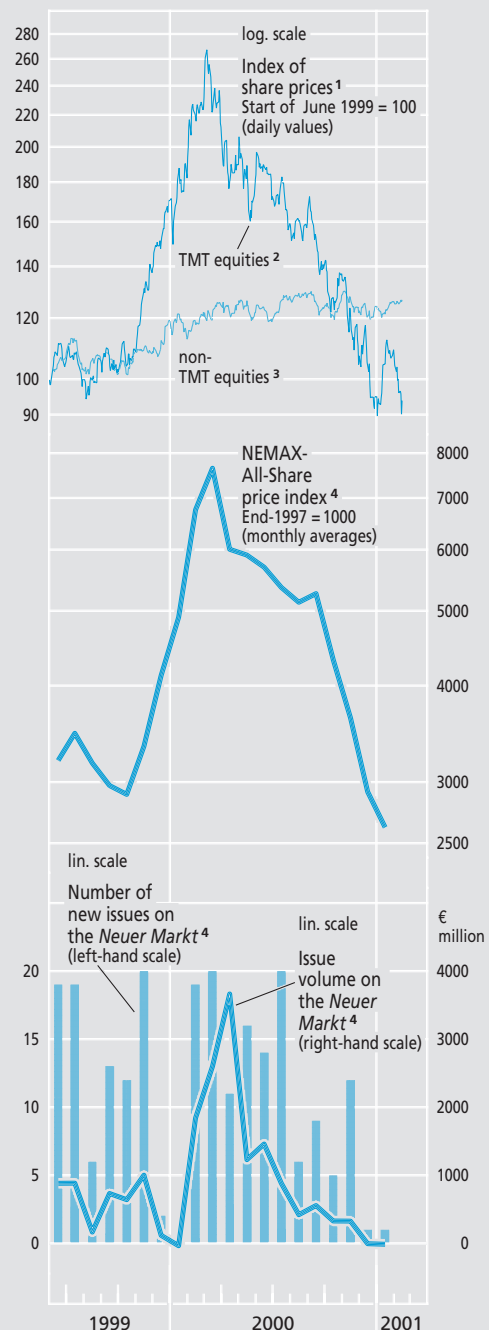
*Decline in
issuing activities
of banks*

The fall in resources raised on the bond market can be primarily attributed to the comparatively slack net sales of bank debt securities, which at € 7.4 billion in the fourth quarter were considerably lower than in the third quarter (€ 30.7 billion). The issues consisted almost exclusively of other bank debt securities (€ 18.7 billion net), while public *Pfandbriefe* were redeemed in the amount of € 11.9 billion. In the fourth quarter the public authorities raised € 11.7 billion net through the bond market, compared with a mere € 1.6 billion in the third quarter. The Federal Government increased its bonded debt by € 10.9 billion, primarily by selling long-term bonds. Thirty-year and ten-year bonds were issued for € 5.2 billion and € 3.5 billion respectively. Net sales of Federal securities compared with redemptions of bonds of the former German Federal Post Office and of the Federal Railways Fund (in total € 2.0 billion). Industrial bonds were sold for € 1.5 billion net.

*Borrowing on
the equity
market*

In the fourth quarter of 2000 domestic enterprises placed new shares to a market value of € 4.2 billion, compared with € 5.5 billion in the previous quarter. As a result of the ongoing downward trend in share prices and the marked reticence of investors, issuing activity on the *Neuer Markt* came almost completely to a standstill. In December and January alike, there was only one new issue. From October to December, a total of 18 enterprises were newly listed on the *Neuer Markt*, roughly half as many as in the third quarter. In comparison with the previous quarter,

Price movements
and issuing activity
on the equity market



1 Source: Primark-Datastream. — 2 Shares of firms in the technology, media and telecommunications (TMT) industries. — 3 Total market excluding TMT shares. — 4 Source: Deutsche Börse AG.

Investment activity in the German securities markets

€ billion; in 1999 excluding money market paper

Item	2000		1999
	July to Sep.	Oct. to Dec.	Oct. to Dec.
Bonds and notes 1			
Residents	39.5	32.8	11.9
Credit institutions 2	19.6	11.8	0.2
of which			
Foreign bonds and notes 3	9.6	11.2	6.7
Non-banks 4	19.9	21.0	11.7
of which			
Domestic bonds and notes	7.9	17.5	9.5
Non-residents 3	20.4	2.4	24.9
Shares			
Residents	33.1	138.7	26.1
Credit institutions 2	-2.6	8.2	11.1
of which			
Domestic shares	-1.0	5.2	6.5
Non-banks 4	35.7	130.5	15.0
of which			
Domestic shares	-3.9	133.1	-36.7
Non-residents 3	10.5	-134.2	36.7
Investment fund certificates			
Investment in specialised funds	9.5	17.9	22.7
Investment in funds open to the general public	7.7	7.7	4.7
of which: Share-based funds	8.9	7.6	5.6

1 Since the beginning of 2000 including debt securities issued by non-banks with an original maturity of up to and including one year plus commercial paper. — 2 Book values, statistically adjusted. — 3 Transaction values. — 4 Residual.

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placed volumes were therefore down again – by 60 % to below € 0.8 billion (see chart on page 25). While the total number of new issues in 2000 (133) exceeded that in the previous year (131), the expectations of a record issue volume still being expressed, in particular, in the spring did not materialise. Between October and December only € 0.3 billion worth of foreign equities were bought by residents on balance, after purchases in the amount of € 38.1 billion had been made in the previous quarter.

Investment activity in the securities markets

Purchases of bonds

Domestic investors were the principal buyers on the bond market in the fourth quarter,

investing € 32.8 billion in debt securities, compared with € 39.5 billion in the previous three months. Domestic non-banks purchased € 21.0 billion worth of bonds (from July to September: € 19.9 billion). € 17.5 billion of this amount was spent on domestic bonds, mostly government issues (€ 9.7 billion). Domestic non-banks acquired € 3.5 billion worth of foreign debt securities. Banks increased their bond holdings by € 11.8 billion, their main interest being in foreign bonds and notes (€ 11.2 billion). Foreign investors reduced their purchases on the German bond market appreciably and bought on balance only € 2.4 billion of domestic debt securities, compared with € 20.4 billion in the previous quarter.

Foreign investors sold € 134.2 billion worth of domestic equities in the fourth quarter, compared with purchases of € 10.5 billion in the previous three-month period. The transfer to a domestic company of a large block of shares which had previously been held abroad as a direct investment played a decisive role (see page 45 of this Monthly Report). Credit institutions topped up their equity portfolios by € 8.2 billion (net), two-thirds of which was accounted for by domestic securities and one-third by foreign securities. Domestic non-banks invested a total of € 130.5 billion in equities, most of which can be attributed to the aforementioned single transaction.

Shares

From October to December sales of domestic investment fund certificates, at € 25.6 billion, were clearly up on the previous quarter (€ 17.2 billion). The increase was related

Investment fund certificates

exclusively to specialised investment funds launched by institutional investors, to which € 17.9 billion were channelled (July to September: € 9.5 billion). Funds open to the general public registered an unchanged inflow of resources of € 7.7 billion. On balance, it went almost exclusively to share-based funds, which raised € 7.6 billion through the sale of their certificates.

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

Continuing decline in overnight deposits

In the deposit business of German MFIs, the overnight deposits of domestic customers declined in the fourth quarter of 2000, measured on a seasonally adjusted basis. To some extent this is due to the fact that as short-term interest rates rose further, so did the opportunity costs of this liquid form of deposits which bear little or no interest. Furthermore, in December last year – similarly to the end of 1999 – the repatriation of euro deposits by German enterprises was far lower than had previously been usual at the end of the year.

Marked increase in short-term time deposits ...

The interest-rate-related portfolio shifts generated an increase, in particular, in deposits with an agreed maturity of up to two years which carry a market rate of interest. They rose by € 18.2 billion in the fourth quarter, compared with € 19.8 billion one year previously. Predominantly employees, but non-financial corporations, too, expanded their holdings of short-term time deposits significantly. By contrast, deposits with agreed maturities of more than two years increased by

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

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

Item	€ billion	
	2000 Oct. to Dec.	1999 Oct. to Dec.
Deposits of domestic non-MFIs 1		
Overnight	+ 29.4	+ 14.8
With agreed maturities up to 2 years	+ 18.2	+ 19.8
over 2 years	+ 2.4	+ 10.5
At agreed notice 2		
up to 3 months	- 1.3	+ 4.8
over 3 months	+ 4.9	+ 1.6
Lending		
Lending to domestic enterprises and individuals		
Loans	+ 19.1	+ 40.3
Lending against securities	+ 6.6	+ 13.8
Lending to domestic public authorities		
Loans	+ 5.5	+ 6.2
Lending against securities	+ 3.9	- 2.3

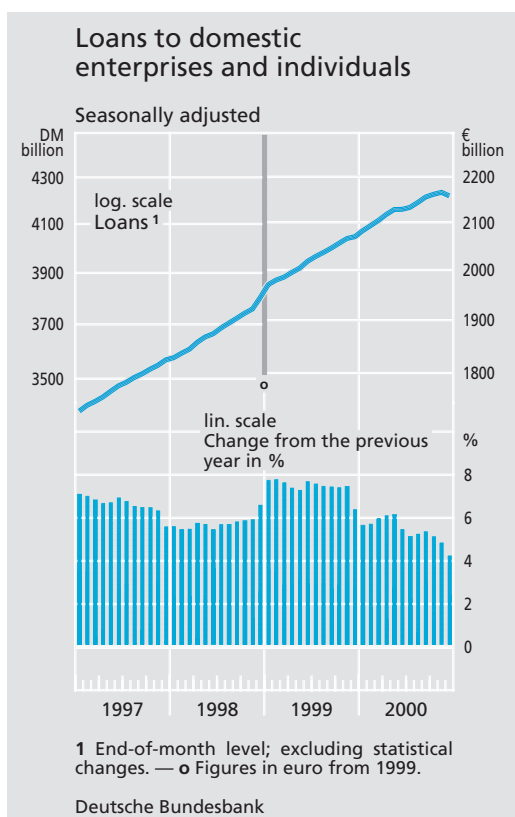
* As well as banks (including building and loan associations, but excluding the Bundesbank), monetary financial institutions (MFIs) here also include money market funds; see also Table IV.1 in the Statistical Section of this Report. — 1 Enterprises, individuals and public authorities. — 2 Savings deposits.

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€ 2.4 billion from October to December, i. e. by far less than in the fourth quarter of 1999 (€ 10.5 billion). In particular, insurance companies, which traditionally hold most of the longer-term time deposits, made comparatively small increases in their portfolios in the fourth quarter of 2000.

The weak development of deposits with an agreed period of notice of three months continued during the period under review. Despite the interest credited at the end of the year, they fell further by DM 1.3 billion. The decline was restricted to traditional savings deposits with an agreed period of notice of three months, while the special savings facilities attracting a higher rate of interest picked up slightly; these, at just under 70 %, make up the bulk of savings deposits. In addition to

Further fall in savings deposits with an agreed period of notice



the time deposits, deposits with an agreed period of notice of more than three months are likely to have benefited from the interest-rate-related shifts from short-term savings deposits which have now been going on for roughly one year. However, despite the year-end interest payments, the recent increase of € 4.9 billion was below that in the previous quarter (€ 5.1 billion).

Decline in lending to the private sector...

Lending by German MFIs to domestic enterprises and individuals declined perceptibly in the fourth quarter. Both lending against securities and loans were affected. After having amounted to just over 5 % in the third quarter, the seasonally adjusted annual increase in loans slumped to just ½ % in the fourth quarter. This significant slump is, however, likely to understate the basic trend of credit expansion.

sion. For one thing, it was partly due to single transactions in December. For another, at the end of 2000 – in contrast to previous years – there were no marked tax incentives for borrowers. Finally, in the third quarter lending was also boosted by the “one-off” effect of the borrowing requirement related to the sale of the UMTS mobile phone licences.

Looking at the sectoral breakdown of borrowers, lending has declined across the board. In the case of employees, the moderate pace of expansion in the past few quarters slowed further during the period under review. The demand for housing loans virtually came to a standstill. Lending to enterprises also remained largely unchanged, although this was mainly due to a larger single transaction in the financing institutions sector. In some larger sectors other than manufacturing and energy and water supply, however, loans also declined on a seasonally adjusted basis.

... across the board

The level of indebtedness of German public authorities to domestic MFIs rose by € 9.3 billion in the fourth quarter, compared with an expansion of € 3.9 billion in the same period in the previous year. Domestic MFIs increased their stocks of domestic government bonds by € 3.9 billion and of loans to the public sector by € 5.5 billion. The Federal Government reduced its bank debts, however, by € 4.1 billion – probably by having recourse to its proceeds from the sale of UMTS mobile phone licences. It ran down its deposits with German MFIs by € 1.7 billion in the period under review.

Increase in public sector debt