Financial markets in Germany

Capital market and bank interest rates

Declining capital market rates

German capital market interest rates declined markedly for a time in the autumn months, before rising again towards the end of the period. The yield on ten-year Federal bonds outstanding fell between mid-August and mid-November by ¼ percentage point to 4½%. Interest rates on Federal securities with a shorter residual maturity, which are influenced more by conditions in the money market, decreased over the same period by as much as ¾ percentage point. The interest rate range of Federal bonds widened, particularly following the interest rate cuts made by the Eurosystem. The estimated yield curve is now likewise correspondingly steeper. In mid-November the interest rate spread between ten-year and one-year Federal bonds observable in the market amounted to more than 1¼ percentage points, compared with ¾ percentage point in mid-August. The gap between German capital market rates and yields in the other euro-area countries again narrowed somewhat. In November ten-year Federal bonds *(Bunds)* were about ¼ percentage point lower than the average euro-area capital market rate in that maturity range.

Divergent risk spread trends

The interest rate spread between ten-year debt securities issued by domestic banks and comparable Federal bonds has narrowed since mid-August. Of late it amounted to just over ⅓ percentage point. By contrast, the interest rate spread of domestic corporate bonds over government bonds widened considerably during the same period. When this Report went to press, the coupon of bonds issued by industrial enterprises in Germany was more than 1½ percentage points higher than that of Federal securities. These divergent trends are presumably due to different assessments of the respective credit standing of the two private bond categories, which were valued anew following the events of September 11 in the United States. As in the European segment, the dimmer economic outlook led to a larger risk premium for corporate bonds (which have a higher default risk) but not for bank debt securities, which generally carry a top-notch rating.

Steeper yield curve

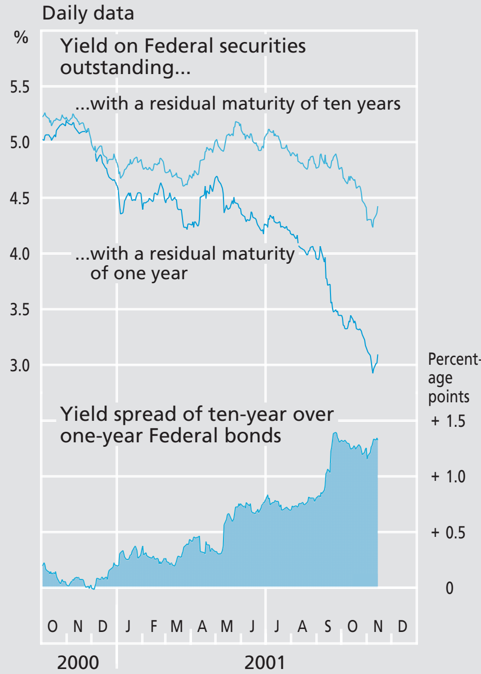
The yield curve has grown steeper at both ends since mid-August in the wake of the sharper fall in the shorter-term segment. However, the yields on longer-dated paper indicate no increase in market players' inflation expectations. That conclusion is borne out by surveys of economic agents' assessment of the long-term price outlook. The inflation expectations computed in this way for the average of the next ten years in Germany amounted to 1.8 % in October. The expected real capital market rate for the ten-year maturity range in October (calculated as nominal yields less inflation expectations) was 2¾ %, compared with around 4 % on average during the 1990s.

Lower bank rates

Bank interest rates declined in autumn 2001 in line with money and capital market rates. Interest rates paid on short-term deposits fell particularly sharply between July and October. In October time deposits with a maturity of one month and three months (for an investment volume of DM 100,000 to less than DM 1 million) attracted only 3.1 % interest, which was around ⅔ percentage point less than in July. Banks' long-term lending rates decreased by roughly ⅓ percentage point. Mortgage loans at a rate of interest locked in for ten years cost 5.9 % in October compared with 6.2 % in July. The effective interest rates for long-term fixed-rate loans to enterprises fell to 6.4 % (for a credit volume of DM 200,000 to less than DM 1 million) and 6.2 % (for a credit volume of DM 1 million to less than DM 10 million). In their short-term lending rates, credit institutions passed on only part of the cut in central bank rates to their customers. In October banks charged 8.6 % for current account credit (for a credit volume of DM 1 million to less than DM 5 million), which was 20 basis points less than in July. The interest rate charged on personal credit lines was also reduced marginally to 12.6 % on average when this Report went to press, which was almost 10 basis points less than in July.

Yields in the German bond market

Daily data



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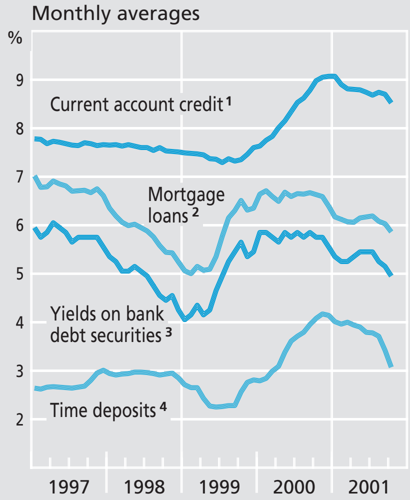
Bank interest rates in Germany

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 one month for amounts of DM 100,000 and more, but less than DM 1 million.

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Share prices

Terror attacks at first accelerated fall in share prices ...

The downward slide in the German equity market initially continued in late summer against the background of the marked overall economic slowdown. Measured by the broad CDAX share price index, equity prices fell by 13 % between the middle of August and September 10, the day before the terror attacks in New York and Washington. Following the attacks, share prices plummeted. Price volatility of German blue-chip stocks concurrently soared to levels last seen during the turbulence on the international financial markets in 1998. Share trading in Germany – unlike in New York – was not suspended in the wake of the events in the United States; turnover was more or less normal. However, open-outcry trading in US equities was halted and the scheduled introduction of electronic trading in US stocks on Xetra was postponed. In addition, German collective investment companies temporarily discontinued the computation of unit shares also of mutual funds that do not invest in the United States.

... then prices recovered

By end-September the situation on the German equity market had already calmed down. Share prices rebounded and, when this Report went to press in mid-November, were 6 % above the level of September 10. Although price volatility abated, it remained at a comparatively high level. On balance, German equities have lost more than 40 % of their stock market value since reaching their historical peak in March 2000; this contrasts with a drop of just over one-third on the Dow Jones Euro STOXX share price index.

Rising share prices on the Neuer Markt segment

The recovery in stock market prices did not embrace all market segments to the same extent. The recovery was particularly pronounced on the *Neuer Markt* segment. In mid-November the NEMAX All-Share price index was 24 % higher than before the attacks. However, these gains need to be seen in the context of the very heavy losses over the past 18 months. Even after the latest increase, the NEMAX index was 80 % below the peak which it had attained in March 2000. Hence the *Neuer Markt* has not yet fully recovered from the crisis.

Borrowing in the securities markets

Sales of bonds

A significantly higher amount of funds were again procured in the German bond market in the third quarter than in the preceding three months. Gross sales of bonds and notes issued by domestic borrowers, calculated at market prices, totalled € 202 billion (previous quarter: € 178 billion). In the context of smaller redemptions and smaller increases in issuers' holdings of their own bonds, net domestic bond sales raised € 36½ billion, thus surpassing the corresponding figure for the whole of the first half of 2001 (€ 30 billion). This total includes short-dated paper with maturities up to one year in the amount of € 4 billion, which in the previous quarter had recorded net redemptions amounting to € 14 billion. By contrast, sales of foreign debt securities, which on balance were exclusively denominated in euro, totalled less than € 7 billion during the period under review, which fell far short of the comparable figure in the second quarter (€ 29 billion). The combined net resources yielded by sales of both domestic and foreign debt securities in the German bond market in the third quarter of 2001 thus came to € 43 billion.

Buoyant issuing activity by both private and public borrowers

The increase in the volume of funds raised in the bond market was due to buoyant issuing activity both by domestic private borrowers and by public authorities. Between July and September German credit institutions issued proprietary debt securities for € 12½ billion net, compared with only € 2 billion in the second quarter. Other bank debt securities were once again to the fore, their outstanding volume rising by nearly € 9 billion. Sales of bank debt securities issued by specialised credit institutions brought in € 6 billion, while mortgage *Pfandbriefe* yielded just under € 3 billion net. By contrast, the net outstanding amount of public *Pfandbriefe* again fell (by € 5 billion). The banks likewise further reduced their liabilities arising from money market paper. Net sales of corporate debt securities reached a record level of € 8½ billion. Enterprises predominantly issued money market paper (€ 5 billion). At € 15½ billion net, government likewise borrowed considerably more in the third quarter than in the preceding three months (€ 5½ billion). The Federal Government accounted for € 14 billion of this; the Länder Governments sold bonds worth € 9½ billion. Debt securities issued by the Federal special funds were redeemed in the period under review in the amount of just over € 8 billion.

Issuing activity in the equity market

Issuing activity in the German equity market picked up a little in the third quarter of 2001 but remained well below the comparable levels of the past few years. Between July and September domestic enterprises placed new shares in the German equity market with a market value of € 4½ billion, as against not quite € 3 billion in the previous three months. IPO business virtually ground to a halt, however. Only one enterprise was newly listed on the stock exchange in the third quarter, compared with nine in the second quarter.

Investment activity in the securities markets

Purchases of bonds

Domestic non-banks, in particular, bought bonds and notes on a sizeable scale in the third quarter. On balance, they increased their portfolios of debt securities by a further € 35 billion, compared with € 18½ billion be-

Investment activity in the German securities markets

€ billion

Item	2001 Apr. to June	2001 July to Sep.	2000 July to Sep.
Bonds and notes [1]			
Residents	41.7	26.7	40.9
Credit institutions [2]	23.1	– 8.2	19.6
of which Foreign bonds and notes [3]	14.1	2.9	8.6
Non-banks [4]	18.6	34.9	21.3
of which Domestic bonds and notes	3.8	31.0	10.2
Non-residents [3]	– 3.4	16.5	18.1
Shares			
Residents	– 23.6	– 9.6	39.8
Credit institutions [2]	– 26.1	– 16.3	– 2.6
of which Domestic shares	– 28.4	– 14.3	– 1.0
Non-banks [4]	2.4	6.7	42.4
of which Domestic shares	– 39.5	8.9	– 4.2
Non-residents [3]	70.9	9.9	10.8
Investment fund certificates			
Investment in specialised funds	2.9	5.9	9.5
Investment in funds open to the general public	5.6	4.5	7.7
of which: Share-based funds	2.0	– 2.1	8.9

1 Since the start of 2000 including non-bank debt securities 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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tween April and June. They mainly favoured paper issued by domestic borrowers (€ 31 billion). Foreign investors were likewise purchasers of domestic debt securities during the summer months (€ 16½ billion), preferring almost exclusively public bonds (€ 15 billion). Non-residents' purchases were heavily concentrated on September. This was no doubt connected with the events of September 11. By contrast, German credit institutions resold € 8 billion net of bonded debt. While they added € 3 billion worth of foreign debt securities to their portfolios, they ran down their holdings of both domestic government bonds and bank debt securities (by € 8½ billion and just under € 3 billion, respectively).

Purchases of shares

Foreign investors were the principal purchasers on the German share market in the third quarter. They bought equities to the net value of € 10 billion. Domestic non-banks acquired shares in German enterprises adding up to € 9 billion net. This contrasts with the German credit institutions, which again sold such securities on balance (for € 14½ net). In addition, both groups of domestic investors reduced their holdings of foreign equities by around € 2 billion. In the case of non-banks a key factor was the large-scale repatriation of international shareholdings in September when the uncertainty in the markets concerning the implications of the terror attacks in the USA was especially great.

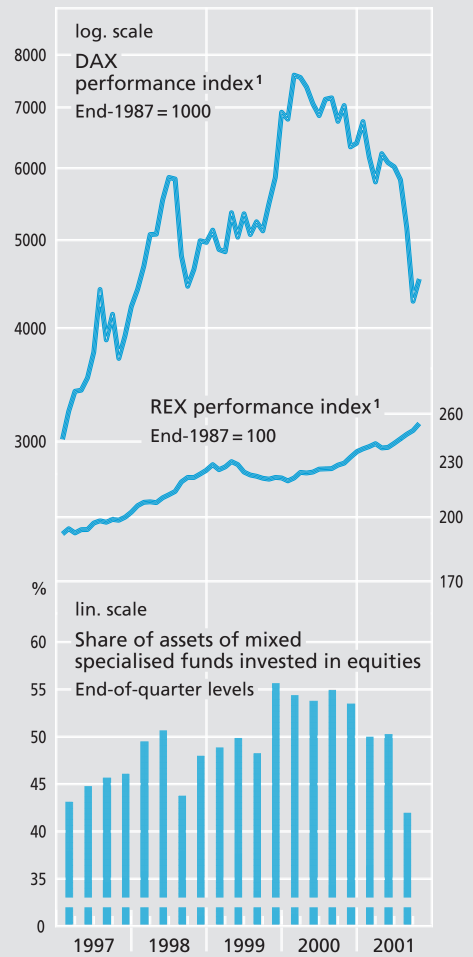
Investment fund certificates

Although sales of mutual fund certificates of domestic collective investment companies recovered somewhat in the third quarter of 2001, they remained at a low level compared with their longer-term trend. Between July and September domestic collective investment companies marketed units worth € 10½ billion net, compared with € 8½ billion between April and June. Net sales of foreign investment certificates, by contrast, showed a slight quarter-on-quarter decrease to not quite € 4 billion.

Investors mainly motivated by security considerations

Between July and September domestic funds open to the general public raised € 4½ billion net from the sale of certificates, which was again a little less than in the previous quarter (€ 5½ billion). Given the volatile stock market situation, retail investors were again more interested in liquid and comparatively safe investment vehicles. This chiefly benefited the money market funds, to which € 3½ billion accrued in the third quarter. Open-end real estate funds likewise remained popular, attracting € 2 billion of fresh resources. These two types of fund together raised the considerable sum of € 14½ billion from investors in the first nine months of this year. Share-based funds, on the other hand, were out of favour. They were obliged to repurchase certificates with a total value of around € 2 billion in the third quarter. This means that the cumulative amount of resources raised by such funds between January and September was only € 2½ billion. In 2000 the sale of equity fund units brought in the record total of € 38½ billion. Institutional investors again showed greater interest in domestic specialised funds in the third quarter, pumping in almost € 6 billion net. Almost half of this sum accrued to mixed funds and another third to bond-based mutual funds. In the case of specialised funds, too, there are signs of restrained investment behaviour. In the wake of the bear market and the related restructuring of portfolios, the percentage of resources invested by mixed securities funds in equities fell of late to well below half.

Capital market trends and equity investments of mixed specialised funds



1 End-of-month levels. Source: Deutsche Börse AG.

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

Large increase in overnight deposits

Domestic customers substantially increased their overnight deposits with German MFIs in the third quarter of 2001, measured on a seasonally adjusted basis. The pronounced preference shown by investors right since the start of the year for this particularly liquid form of saving appears to have been reinforced in the third quarter by the growing liquidation of stored cash, the fall in interest rates and the continuing decline in stock market prices. The terrorist assaults in the USA on September 11 had a similar effect as they caused uncertainty in the financial markets to swell appreciably. In particular, other financial intermediaries and households significantly stepped up their overnight deposits with domestic MFIs in the third quarter; at the end of September 2001 the sum total of overnight deposits of all domestic non-banks lodged

Lending and deposits of monetary financial institutions (MFIs) in Germany *

€ billion

Item	2001 July to Sep.	2000 July to Sep.
Deposits of domestic non-MFIs 1		
Overnight	+ 17.6	– 13.6
With agreed maturities		
up to 2 years	+ 5.4	+ 12.3
over 2 years	– 0.1	+ 0.6
At agreed notice 2		
up to 3 months	– 0.1	– 16.6
over 3 months	– 3.2	+ 5.1
Lending		
To domestic enterprises and individuals		
Unsecuritised	+ 7.6	+ 23.0
Securitised	– 7.9	+ 5.0
To domestic public authorities		
Unsecuritised	– 2.4	– 8.8
Securitised	– 8.2	– 5.8

* 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 (excluding the Federal Government). — 2 Savings deposits.

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with German MFIs was 15.6 % higher than at the same time last year.

Moderate increase in short-term time deposits

By contrast, deposits with an agreed maturity of up to two years expanded only moderately in the third quarter. In this case, too, the rise was principally attributable to other financial intermediaries and households. Deposits with an agreed maturity of up to two years expanded overall between July and September by € 5.4 billion; in the third quarter of 2000 the increase had amounted to € 12.3 billion.

Stagnation of longer-term time deposits

Deposits with an agreed maturity of more than two years were virtually unchanged during the period under review after having grown briskly in the second quarter (+ € 2.3 billion) and moderately between July and September last year (+ € 0.6 billion). Domestic insurance enterprises, which are traditionally the most important investor group for deposits with an agreed maturity of more than two years, have displayed marked restraint of late in the pattern of their longer-term saving with German MFIs. They were thus unable to counterbalance the sustained fall in longer-term time deposits on the part of households.

Savings deposits at three months' notice virtually unchanged ...

Contrary to the usual seasonal pattern, deposits with an agreed period of notice of three months hardly decreased at all in the third quarter of 2001 (– € 0.1 billion). This was because the first noticeable increase observed since the beginning of 1999 in special savings facilities attracting a higher rate of interest largely offset the ongoing decline of "conventional" savings deposits redeemable at three months' notice. The apparent rise in attractiveness of more highly remunerated short-term savings deposits is presumably due mainly to the far less pronounced slide in their interest rates compared with longer-term savings deposits.

... also owing to shifts within savings deposits

Savings deposits redeemable at a period of notice of over three months, which grew strongly during last year's phase of rising interest rates, have contracted distinctly since the spring months; they decreased by € 3.2 billion between July and September. Some of this may have been rechannelled into short-term savings deposits.

Slight rise in lending to the private sector ...

Lending by German MFIs to domestic enterprises and individuals rose slightly in the third quarter, after having actually fallen in the preceding three months, not least as a result of extensive disposals of securities by German MFIs in connection with forward transactions. However, even unsecuritised loans to the domestic private sector, which are not affected by such transactions, grew during the period under review only at a seasonally adjusted annual rate of just over 2 %. The growth of loans was again fuelled principally by a moderate increase in medium and long-term borrowing, whereas short-term loans showed a marginal decrease after seasonal adjustment.

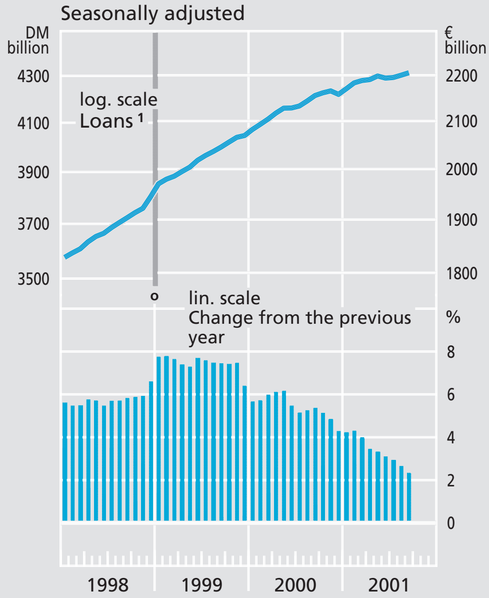
... and to enterprises

Of the main groups of borrowers, enterprises expanded their credit from domestic MFIs a little in the third quarter after having cut it appreciably in the preceding three months. Above all service providers, but also other financial intermediaries and insurance enterprises, took up considerably more resources from German MFIs in the period under review than between April and June (measured on a seasonally adjusted basis). A certain counterweight to this came from a sharp drop in bank loans to transport and communication enterprises (in part this was a counterswing following the steep rise in the second quarter) and the persistent decline in loans to the manufacturing sector. The moderate expansion of housing loans seen in the previous quarters continued; by contrast, borrowing by employees declined slightly.

Further decrease in public sector debt

As in the second quarter, the level of indebtedness of German public authorities to domestic MFIs decreased by € 10.6 billion; in the third quarter of 2000 the decline had amounted to € 14.6 billion. In contrast to the pattern seen during the spring months, when solely the volume of unsecuritised loans was reduced, the decline in government debt owed to banks this time mainly took the form of a fall in domestic MFIs' holdings of securitised claims on German public authorities (– € 8.2 billion). The decrease in loans by € 2.4 billion chiefly concerned lending to the Federal Government, whose deposits held with German MFIs similarly decreased by € 1.2 billion.

Loans to domestic enterprises and individuals



1 End-of-month level; excluding statistical changes. — o Figures in euro from 1999.

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