Financial markets in Germany

Capital market and bank interest rates

Rise in capital market rates

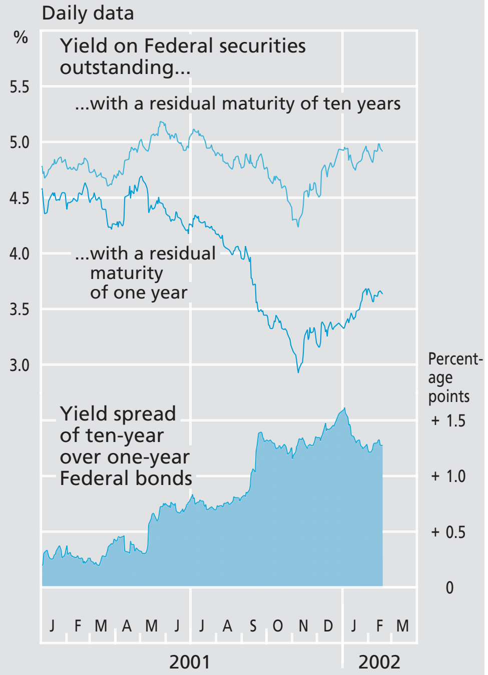
German capital market interest rates rose at the turn of the year. Between mid-November and mid-February the yield on ten-year Federal bonds outstanding went up by just under ½ percentage point to almost 5 %. Interest rates on Federal securities with a shorter residual maturity – which are affected more strongly by expectations in the money market – also increased in the same period by almost ½ percentage point. The interest rate advantage of ten-year Federal bonds over one-year paper observable on the market therefore remained virtually unchanged at just over 1¼ percentage points. The interest rates for ten-year Federal bonds (Bunds) fell to 19 basis points below the average euro-area capital market rate, a slide of 6 points. Given the relatively strained public finances in Germany, the yield spread of ten-year bonds issued by domestic banks over comparable Federal bonds fell by 10 basis points to ¼ percentage point as well.

Yield curve by and large unchanged

In recent months the yield curve shifted upwards across the whole maturity spectrum. Inflation expectations remained low – as expert surveys show – and the increase in the yields on both short-term and long-term Federal securities suggest that market players are again taking a somewhat more favourable view of the economic outlook. This is also reflected by the fact that the interest rate spread between bonds and money market paper is now more pronounced again. In line with this, the increase in nominal yields was carried over to real interest rates in the ten-year maturity range as expected by the mar-

Yields in the German bond market

Daily data



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ket; at 3¼% in January, these were more than ½ percentage point up on November.

Slightly lower short-term bank rates and rising long-term rates

Between November and January short and long-term bank interest rates diverged slightly. The banks raised their long-term rates in line with capital market rates. After hitting a low in November, the cost of mortgage loans at a rate of interest locked in for ten years subsequently rose by around ¼ percentage point to 6.0%. The effective interest rates for long-term fixed-rate loans to enterprises went up to 6.5% (for a credit volume of € 100,000 to less than € 500,000) and 6.2% (for a credit volume of € 500,000 to less than € 5 million). Banks initially passed on only part of the early-November cut in central bank rates to their customers in their short-term lending rates. In the months up to January, however, they made a further slight reduction in their interest rates, charging 8.4% for current account credit (for a credit volume of € 500,000 to less than € 2½ million), 10 basis points less than in November. The interest rate charged on personal credit lines was also reduced marginally to an average of 12.5% at the end of the period under review. At 2.7%, the interest paid on fixed-term deposits with a one-month or a three-month maturity (for an investment volume of € 50,000 to less than € 500,000) was also reduced slightly in January. The same was true of savings deposits with a three-month period of notice.

Share prices

Sideways movement in the equity market

The rebound of prices in the German equity market, which followed the sharp decline in the wake of the 11 September attacks, did not continue during the winter months. Although market participants apparently assumed that the economic situation would soon recover, analysts' profit forecasts, some of which were scaled down significantly, and concerns about corporate insolvency both weighed heavily on stock market quotations. Against this backdrop, trade turnover decreased but there was generally only a slight change in share prices. As measured on the broad CDAX share price index, the quotations when this *Monthly Report* went to press were virtually at the level reached in mid-November 2001. Compared with their historical peak in March 2000, German shares have therefore still lost around 40% of their stock market value; this contrasts with a drop of over one-third on the Dow Jones EuroStoxx share price index. Since the start of 2002, however, German equities have recovered some ground by comparison with the European average. The minor price fluctuations in the period under review led to a decline in market players' uncertainty about the future development of German blue chips. The implied volatility on DAX futures contracts (VDAX), which had reached peak figures in September, decreased further at the turn of the year.

Mid-cap stocks favoured

Quotations on the Neuer Markt fell further, following an especially strong recovery up to mid-November. In the past three months the NEMAX all-share price index fell by more than 15 %. Mid-cap stocks fared better. Having already proved more resistant during the slump, between mid-November and mid-February the share prices of enterprises listed on the MDAX demonstrated better growth than the market as a whole, showing a slight gain of 3 %. In particular, the generally more favourable valuation of these shares is likely to have boosted their prices.

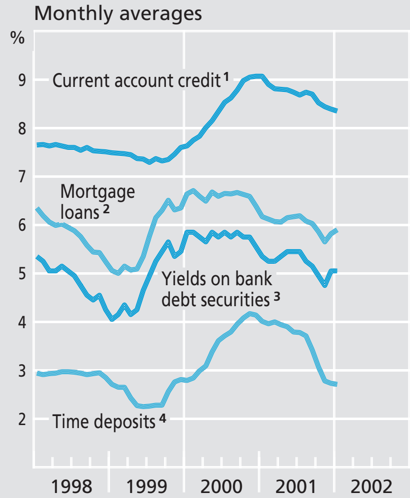
Borrowing in the securities markets

Lower sales by domestic issuers, large amounts of resources raised by foreign issuers

The amount of funds procured in the German bond market in the fourth quarter of 2001 was again rather low. Calculated at market prices, gross sales of bonds and notes issued by domestic borrowers, at € 213 billion, were up on the previous quarter (€ 202 billion). However, since redemptions and increases in issuers' holdings of their own bonds were, on the whole, considerably larger than in the preceding period, net sales of domestic fixed interest securities raised only € 20 billion, as opposed to € 36½ billion in the third quarter of 2001. In 2001 as a whole, domestic borrowers raised fewer funds by issuing bonds (€ 86½ billion) than in any of the preceding ten years. Between October and December 2001 they sold only longer-term paper with maturities of more than one year. However, the volume of domestic money market paper outstanding fell by almost € 5 billion, after having increased by € 4 billion in the previous quarter. Foreign issuers upped their borrowing considerably compared with the previous period – from € 7½ billion net to € 24 billion. They, too, sold longer-term debt securities only, over half of which were denominated in euro. Overall, net sales of debt securities in the German bond market thus came to € 44 billion in the final quarter of 2001.

Bank interest rates in Germany

Monthly averages



1 €500,000 and more, but less than €2.5 million. — 2 On residential property; effective interest rate, fixed rate over ten years. — 3 With a mean residual maturity of over nine and up to ten years. — 4 Time deposits with an agreed maturity of one month for amounts of €50,000 and more, but less than €500,000.

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Investment activity in the German securities markets

€ bn

Item	2001 July to Sep	2001 Oct to Dec	2000 Oct to Dec
Bonds and notes 1			
Residents	29.0	34.4	26.0
Credit institutions 2	– 8.2	– 1.9	– 11.8
of which			
Foreign bonds and notes 3	2.9	3.2	2.0
Non-banks 4	37.2	36.2	14.2
of which			
Domestic bonds and notes	32.8	15.5	12.1
Non-residents 3	14.7	9.7	7.9
Shares			
Residents	– 9.8	4.9	136.8
Credit institutions 2	– 16.3	– 2.2	8.2
of which			
Domestic shares	– 14.3	2.2	5.2
Non-banks 4	6.5	7.0	128.6
of which			
Domestic shares	8.7	5.0	135.8
Non-residents 3	10.1	– 1.2	– 136.8
Investment fund certificates			
Investment in specialised funds	5.9	20.3	17.9
Investment in funds open to the general public	4.5	13.4	7.7
of which			
Share-based funds	– 2.1	2.4	7.6

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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Low levels of borrowing by the private sector

The volume of funds raised by the sale of German bonds largely benefited the public sector. Public authorities raised € 16 billion net from the sale of their own bonds, roughly as much as in the previous quarter (€ 15½ billion). The Federal Government accounted for € 8½ billion of this; the Land governments increased their liabilities relating to fixed-interest securities by just under € 8 billion. Between October and December 2001 German credit institutions issued proprietary bonds in the amount of some € 5 billion (net) only, compared with € 12½ billion between July and September. Only the specialised credit institutions achieved a positive sales result in the fourth quarter, issuing € 15 billion net worth of debt securities (€ 6 billion in the previous period). The net amount of public Pfandbriefe outstanding declined, however, by more than € 6 billion; other bank debt securities and mortgage Pfandbriefe were redeemed on balance for € 3½ billion and € ½ billion, respectively. In the period under review the banks further reduced their liabilities arising from short-term money market paper (-€ 7½ billion). Having reached a record level of € 8½ billion net in the previous quarter, the volume of corporate bonds outstanding fell by € 1 billion.

Small amounts raised in the equity market

Issuing activity in the German equity market picked up only slightly in the last three months of 2001. Domestic enterprises placed new shares with a market value of € 6 billion, as opposed to € 4½ billion in the third quarter. This was accounted for solely by capital increases made predominantly by unlisted enterprises; there has been no IPO business since last summer. The continued limited raising of capital in the equity market was reflected in the overall result for last year, which, at € 17½ billion, was the lowest since 1997.

Investment activity in the securities markets

Purchases of bonds

Domestic investors continued to invest heavily in bonds and notes in the autumn months; their purchases amounted to € 36 billion, compared with € 37 billion in the previous quarter, and showed a particular preference for foreign bonds (€ 21 billion). Their purchases of domestic debt securities raised € 15½ billion on balance, whereas they had added € 33 billion worth of this kind of paper to their portfolios in the previous quarter. They focused solely on public sector debt instruments (€ 16½ billion). In the fourth quarter of 2001 foreign investors also concentrated primarily on purchasing bonds, adding a further € 10 billion to their portfolios of domestic debt securities (compared with € 15 billion in the previous quarter). On balance, foreign investors purchased bank bonds only, with one major transaction between a German bank and one of its foreign branches playing a significant role (see page 45). German credit institutions ran down their holdings of bonds by a further € 2 billion (compared with -€ 8 billion in the previous quarter). Although they purchased € 3 billion net worth of foreign bonds, they reduced their holdings of domestic debt securities by € 5 billion, selling bank debt securities (€ 6 billion) and corporate bonds (€ ½ billion) and purchasing € 1½ billion worth of public bonds.

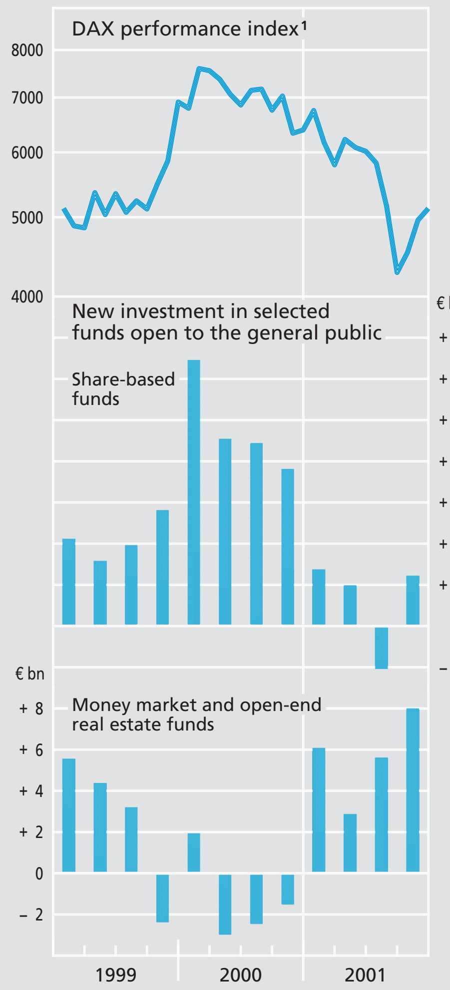
Purchases of shares

Domestic non-banks were the sole purchasers on the German equity market in the fourth quarter. They added € 7 billion net worth of foreign and domestic equities (€ 5 billion and € 2 billion, respectively) to their portfolios. Foreign investors sold German shares in the amount of € 1 billion on balance, after having topped up their holdings by € 10 billion in the summer months. Domestic banks were again selling, with sales totalling € 2 billion, compared with € 16½ billion in the previous quarter. Sales were solely of foreign equities (-€ 4½ billion).

Far higher inflows into investment funds

In the final quarter of 2001, domestic collective investment companies upped their sales of mutual fund certificates considerably, acquiring investments amounting on balance to € 33½ billion. This far exceeded the result of the previous quarter (€ 10½ billion) and of the corresponding period in 2001 (€ 25½ billion). However, at € 4 billion, net sales of foreign investment fund certificates remained unchanged in relation to those two reference periods. As is usual towards the end of the year, a particularly large amount of funds, € 20½ billion, was raised through domestic specialised funds. Roughly half of this amount related to mixed funds (€ 9½ billion) and al-

Equity prices and selected investment in funds



1 End-of-month levels; end-1987=1000. Source: Deutsche Börse AG.

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

€ bn

Item	2001 Oct to Dec	2000 Oct to Dec
Deposits of domestic non-MFIs 1		
Overnight	+ 45.6	+ 29.4
With agreed maturities		
up to 2 years	+ 1.6	+ 18.1
over 2 years	+ 1.0	+ 2.4
At agreed notice 2		
up to 3 months	+ 21.8	– 1.3
over 3 months	– 2.7	+ 4.9
Lending		
To domestic enterprises and individuals		
Unsecuritised	+ 16.8	+ 19.4
Securitised	+ 8.5	+ 6.7
To domestic public authorities		
Unsecuritised	+ 1.4	+ 5.5
Securitised	+ 1.8	+ 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 the *Monthly Report*. — 1 Enterprises, individuals and public authorities (excluding the Federal Government). — 2 Savings deposits.

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most the same amount to bond-based funds (€ 8 billion). Equity fund units and open-end real estate funds brought in € 1½ billion and € 1 billion, respectively. Similarly, domestic investment funds open to the general public sold a far larger volume of share certificates in the fourth quarter, amounting to € 13½ billion net. All in all, institutional investors were still tending to be cautious, preferring less risky investment categories. This chiefly benefited the money market funds and the open end real estate funds, to which € 4½ billion and € 3½ billion accrued, respectively. Share-based funds did not have to redeem any more share certificates, however, and sold certificates for € 2½ billion net.

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

Sustained increase in overnight deposits

Domestic customers again substantially increased their overnight deposits with German MFIs in the fourth quarter of 2001. This was furthered by the continued low level of interest rates and the still high level of uncertainty among financial market investors. Moreover, in the run-up to the introduction of the euro banknotes and coins, funds were rechannelled to these deposits from currency in circulation. Accordingly, employed persons were the main investors in overnight deposits held by domestic MFIs. Contrary to the usual practice in December, they did not run these deposits down at the end of the year, but increased them perceptibly, presumably through inpayments of cash. Overall, overnight deposits of all domestic non-banks with German MFIs went up by 18.2 % last year.

Perceptible reduction in short-term time deposits ...

After adjustment for seasonal variations, deposits with an agreed maturity of up to two years were reduced appreciably in the final quarter of 2001; in the earlier part of the year some of them had shown a marked increase. Contrary to what is otherwise customary practice in December, households, in particular, did not form any short-term time deposits. Instead, they made fairly large-scale purchases of domestic money market fund certificates and increased their deposits with an agreed maturity of three months. The re-

... and a sharp increase in short-term-savings deposits

awakened interest of domestic investors in short-term savings deposits can probably be explained by the fact that interest rate cuts in recent months had made the remuneration on these deposits more attractive than either short-term time deposits or other types of deposits. Owing to the introduction of euro banknotes and coins, some cash was also probably transferred to savings accounts.

Hardly any demand for long-term time deposits ...

Deposits with an agreed period of notice of more than two years attracted little attention in the fourth quarter of 2001 (€ 1.0 billion, compared with € 2.4 billion in 2000). It was not only among employed persons that restraint was evident. Contrary to their usual practice at this time of the year, domestic insurance companies, which are traditionally the most significant group of investors in this type of deposit, in fact made a marked reduction in their holdings of longer-term time deposits with German MFIs.

... and further reductions in longer-term savings deposits

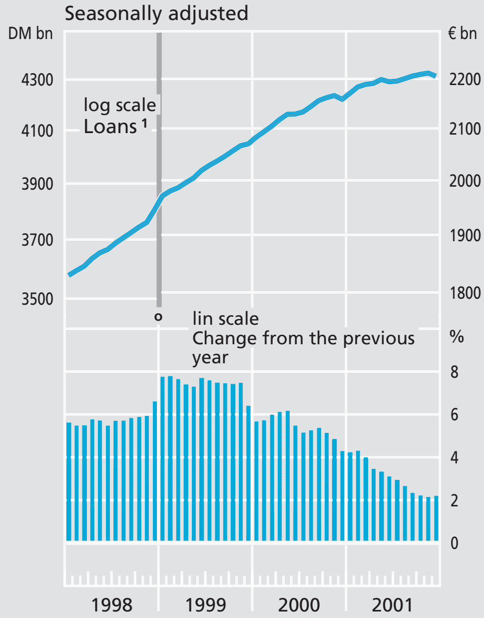
Deposits with an agreed period of notice of more than three months were also scaled down in the fourth quarter (-€ 2.7 billion); one year previously they had been topped up by € 4.9 billion. The reversal is likely to be due to the fact that, at the end of 2000, the interest rate advantage of longer-term savings deposits over short-term savings facilities attracting a higher rate of interest, which was still quite considerable at the end of 2000, was virtually halved in the course of 2001.

Weak lending to the private sector ...

Seasonally adjusted lending by German MFIs to the domestic private sector rose only slightly in the final quarter of 2001. Moreover, on balance only securitised credit was issued; in particular, MFIs purchased large volumes of shares in domestic enterprises. By contrast, loans to the domestic private sector stagnated overall as the sharp decline in December fully offset the increase which had

Loans to domestic enterprises and individuals

Seasonally adjusted



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

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taken place in the previous two months. Loans went up by 2.2 % during 2001.

... and in the corporate sector

The currently limited dynamism of loans to the private sector in Germany is reflected in the borrowing behaviour of all the major groups of borrowers. In addition to housing loans, consumer borrowing was also reduced in the fourth quarter in seasonally adjusted terms. Conversely, enterprises increased their loans from domestic MFIs slightly. The increase in lending was focused on energy and water supply. By contrast, there was a further cutback in loans to the manufacturing sector. Over the year as a whole this economic sector also marginally reduced its loans from German MFIs on balance; in 2000 these had risen perceptibly. In the services sector, too, the demand for loans – which had previously been quite high – eased off.

Public sector borrowing

The indebtedness of domestic public authorities with German MFIs increased by € 3.2 billion in the fourth quarter of 2001, compared with € 9.4 billion during the same period in 2000. Both securitised and unsecuritised lending were affected by the increase. Securitised lending went up by € 1.8 billion and loans by € 1.4 billion. However, at the end of the year the Federal Government pruned the volume of its loans from domestic MFIs (by € 3.1 billion). At the same time, it reduced its deposits in the German MFI sector by € 7.1 billion.