Financial markets in Germany

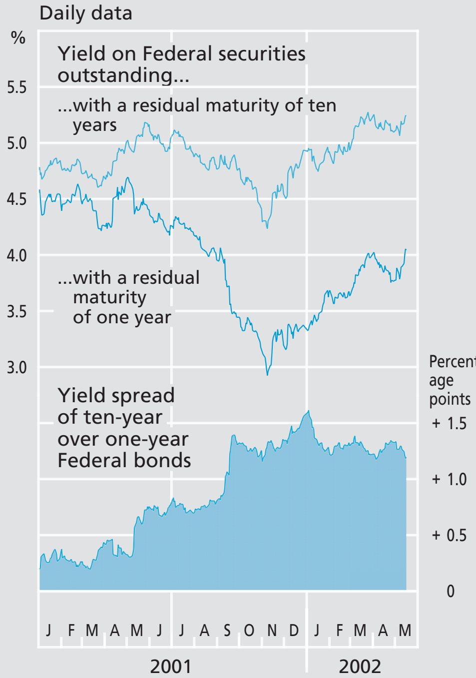
Capital market and bank interest rates

Rise in capital market rates

German capital market interest rates again rose slightly in the spring quarter on balance in line with US and European yields. The yield on ten-year Federal bonds outstanding in mid-May was 5¼%, which was just under ⅓ percentage point higher than in mid-February. Interest rates on Federal securities with a shorter residual maturity rose a little more. The interest rate spread of ten-year Federal bonds over one-year paper narrowed marginally to 119 basis points. The interest rate discount on ten-year Federal bonds compared with the average rate of other European government bonds, which in autumn 2001 had amounted to roughly 25 basis points, contracted to around 19 points as from February 2002. The yield spread of ten-year debt securities issued by domestic banks over comparable Federal bonds remained fairly small in the period under review, at roughly ¼ percentage point. Long-term inflation expectations (based on polls conducted among experts) increased slightly in the course of spring. At around 3¼%, the expected real long-term interest rate nevertheless remained relatively low.

Little change in short-term bank rates, rising long-term rates

Whereas short-term bank interest rates, which are more strongly influenced by terms in the money market, showed little change between January and April, the longer-term debit interest rates rose slightly in line with capital market rates. The cost of mortgage loans at a rate of interest locked in for ten years increased by just over ⅓ percentage point to 6.3%. The effective interest rates for long-term fixed-rate loans to enterprises went up by a similar margin to 6.8% (for a credit volume of €100,000 to less than €500,000) and 6.6% (for a credit volume of €500,000 to less than €5 million). In April banks charged 8.5% for current account credit (for a credit volume of €500,000 to less than €2.5 million), which was a fraction more than in January. By contrast, interest rates charged on personal credit lines were reduced marginally to an average of not quite 12½% at the end of the period under review. On the liabilities side of the balance sheet, the interest rate paid on fixed-term deposits with a three-month maturity (for an investment amount of €50,000 to less than €500,000) stood at 2.8% in April, which was slightly higher than in January, whereas the rate of interest paid on deposits with a one-month maturity decreased somewhat to 2.7%.



Share prices

Sideways movement in the equity market

When this *Monthly Report* went to press, prices in the German equity market, as measured on the broad CDAX share price index, were 2% up on their level in mid-February. For a time the quotations were boosted by positive leading indicators of business activity which nurtured expectations of a rapid and strong economic recovery. Stock prices fell again, however, when those expectations evaporated. Consequently, German shares were still more than 40% down compared with their historical peak in March 2000.

Given the reduced share price volatility during the period under review, market players' uncertainty concerning the likely evolution of German blue chip prices likewise lessened initially before increasing towards the end of the quarter amid a more sceptical mood concerning the scale of the upswing.

Mid-caps again favoured

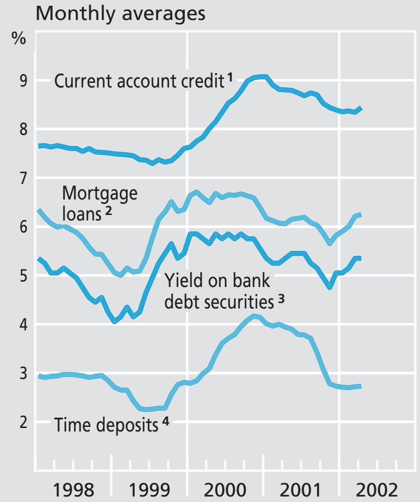
The individual stock market segments displayed rather divergent trends of late. Thus quotations on the Neuer Markt segment for new and growth stocks again came under pressure. In the past three months the NEMAX all-share price index fell by 12%. By contrast, the share prices of mid-cap enterprises listed on the MDAX improved by a further 3%.

Borrowing in the securities markets

Sales activity in the German bond market picked up in the first quarter of 2002. Calcu-

Bank interest rates in Germany

Monthly averages



1 5500,000 and more, but less than 52.5 million. — 2 On residential property; effective interest rate, locked in for 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 550,000 and more, but less than 5500,000.

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Higher bond market sales, especially in the longer-term segment

lated at market prices, gross sales of debt securities issued by domestic borrowers rose from €213 billion in the fourth quarter of 2001 to €239½ billion. After deducting redemptions and adjusting for changes in issuers' holdings of their own bonds and notes, net sales amounted to €48½ billion, as opposed to €20 billion between October and December of last year. In net terms, only bonds with maturities of more than one year were issued. By contrast, the volume of money market paper outstanding fell by a further €6 billion. Sales of foreign bonds and notes, which on balance were exclusively denominated in euro, declined compared with the preceding quarter from €24½ billion to €19 billion. Total sales of debt securities in the German bond market in the first quarter of 2002 thus came to €67½ billion.

Brisk issuing activity by banks

The rise in borrowing was caused primarily by increased issuing activity by credit institutions. In the first three months of this year they raised €35 billion net from selling their own debt securities, compared with only €5 billion in the previous quarter. Their favoured issuance vehicle was other bank debt securities, which brought in €20 billion. But larger amounts of debt securities issued by specialised credit institutions and mortgage *Pfandbriefe* were also sold (for €8 billion in each case). As in the preceding three months, the net amount of public *Pfandbriefe* outstanding declined. The public sector increased its indebtedness on the bond market in the first quarter by €13 billion. The biggest public borrower was the Federal Government, which issued new paper in the amount of €20 billion. The *Land* governments sold debt securities worth €6 billion. The special Federal funds, especially the "German Unity" Fund and the Treuhand agency, redeemed €10 billion worth of their outstanding bonds. The volume of corporate bonds outstanding rose by €½ billion.

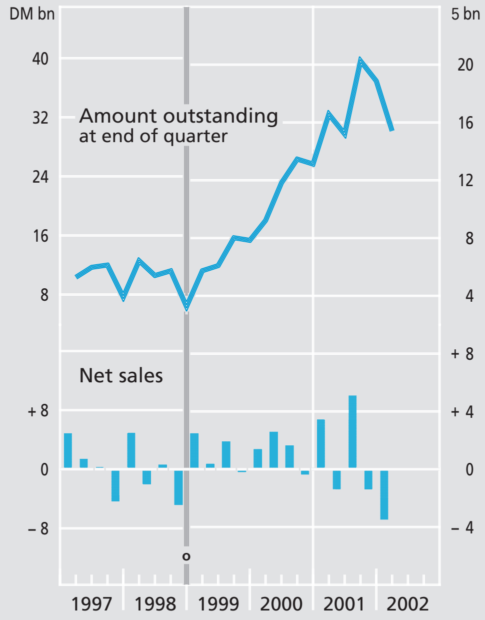
Sharp drop in financing via commercial paper

The outstanding amount of commercial paper issued by domestic industrial and commercial enterprises contracted by about one-third during the period under review. This is rather atypical and might indicate a worsening of firms' short-term financing situation, given that in the past sizeable redemptions of commercial paper – unsecured discount paper with maturities of less than one year that is traded in the money market – tended to be made at the end of a year or half-year. Commercial paper, the creditworthiness of which is rated by the big agencies, has played only a minor role in Germany to date, although increasing use has been made of this vehicle in recent years for short-term corporate financing in view of its lower interest rates compared with bank loans.

Less capital raised on the equity market

In the first three months of 2002 domestic enterprises placed new shares with a market value of €3½ billion. This was only half the volume of new shares issued in the equity market in the last three months of 2001, even though the first initial public offering (IPO) in six months was launched on the Neuer Markt segment in March. The net volume of foreign equities sold came to €15½ billion, so that the total amount of resources procured on the German stock market came to €19 billion.

Commercial paper issued by domestic non-banks



o From 1999 in euro.

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Investment activity in the securities markets

Purchases of debt securities

Domestic non-banks were the principal purchasers in the German bond market in the first quarter of 2002. They expanded their bond portfolios by €44½ billion. Three-quarters of the total were domestic bonds and notes. German credit institutions bought debt securities worth €22 billion net, mostly in the form of domestic bank debt securities (€11½ billion). They invested €9 billion in foreign securities, predominantly paper denominated in foreign currencies. Non-resident investors acquired German debt securities in the net amount of €1 billion in the early part of this year, whereas they had added €12½ billion worth of German bonds and notes to their portfolios in the previous quarter. This decrease is solely attributable to the offloading of money market instruments for €22 billion net.

Purchases of shares

Domestic non-banks purchased equities totalling €19 billion in the first quarter. Foreign shares made up the bulk of this total. During the same period foreign investors added €9 billion net worth of German equities to their portfolios. Following a lull of six months, they again undertook portfolio investments on a major scale (€6 billion). As in the preceding quarter, domestic credit institutions resold shares (for €8½ billion).

Steady inflow of resources to public mutual funds

Sales of domestic investment fund certificates between January and March amounted to €18½ billion, which was well down on the total in the preceding quarter (€33½ billion).

Investment activity in the German securities markets

€ bn

Item	2001 Oct to Dec	2002 Jan to Mar	2001 Jan to Mar
Bonds and notes			
Residents	32.4	66.7	57.8
Credit institutions 1	– 1.9	22.3	22.8
of which Foreign bonds and notes 2	3.2	9.1	17.5
Non-banks	34.3	44.4	35.0
of which Domestic bonds and notes	13.0	34.1	20.5
Non-residents 2	12.3	0.9	– 5.1
Shares			
Residents	14.3	10.3	6.6
Credit institutions 1	– 2.2	– 8.6	29.8
of which Domestic shares	2.2	– 5.4	23.3
Non-banks 3	16.4	18.8	– 23.2
of which Domestic shares	4.9	0.1	– 25.1
Non-residents 2	– 1.1	8.9	5.9
Investment fund certificates			
Investment in specialised funds	20.3	5.0	12.2
Investment in funds open to the general public	13.4	13.7	12.1
of which: Share-based funds	2.4	1.0	2.8

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

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This drop in the inflow of resources was due to the poorer performance of the specialised investment funds in line with the seasonal pattern; on balance they received €5 billion, compared with €20½ billion in the last quarter of 2001. By contrast, the inflow of new cash accruing to investment funds open to the general public, at €13½ billion, matched the prior-quarter total. Demand focused on open-end real estate funds, which recorded inflows of €7 billion. Bond-based funds and money market funds both obtained €2½ billion, whereas new investment in share-based mutual funds, which carries a greater risk, was again moderate, at €1 billion net. Units of foreign mutual funds were sold in Germany for €7½ billion net.

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

Smaller increase in overnight deposits

In the first quarter of 2002 domestic customers increased their overnight deposits with German MFIs at a much slower pace than before (measured on a seasonally adjusted basis). Even so, their deposits expanded at a seasonally adjusted annualised rate of over 7%. The ongoing preference for this highly liquid form of investment indicates that it may be some time before a more normal pattern of investment activity is resumed. Moreover, German investors – especially employed persons – currently seem to be favouring liquidity more than investors in other euro-area states; at the EMU-wide level, overnight deposits fell appreciably during the period under review in seasonally adjusted terms.

Accelerated fall in short-term time deposits…

The reduction of deposits with an agreed maturity of up to two years continued apace in the first quarter of 2002. In January, in particular, the volume of short-term time deposits was depleted substantially (after adjustment for seasonal variations). This presumably owed something to the divergent interest rate trends: falling interest rates for short-term time deposits (due to seasonal factors) and rising rates for longer-term time deposits. Domestic insurance companies, in particular, appear to have shifted substantial amounts of short-term time deposits into longer-term time deposits.

… but marked rise in long-term time deposits

Deposits with an agreed maturity of more than two years showed a corresponding sharp expansion in the first quarter of 2002, increasing by €7.3 billion; this contrasted with the stagnant trend shown in the two preceding quarters on account of the marked uncertainty prevailing in the financial markets. Employed persons, by contrast, continued to display little enthusiasm for long-term time deposits with German MFIs.

Short-term savings deposits in demand

In the first quarter of this year domestic investors again topped up their savings deposits with an agreed period of notice of up to three months. Although even the better remunerated special savings instruments with an agreed period of notice of three months usually have an interest rate disadvantage, depending on the amount and duration of the investment, compared with other interest-bearing bank deposits (especially time deposits and longer-term savings deposits), they have the advantage of comparatively high liquidity. The amount which investors may withdraw without notice or penalty from a savings deposit with an agreed period of notice of three months was increased at the beginning of the year to €2,000 per month.

Longer-term savings deposits reduced

Deposits with an agreed period of notice of over three months were run down further in the first quarter (by €5.7 billion); one year earlier they had fallen by only €0.5 billion. As a result, the shift towards short-term savings deposits strengthened, despite a somewhat steeper yield curve for deposits with a longer period of notice.

Persistently weak lending to the private sector

Seasonally adjusted lending by German MFIs to the domestic private sector fell noticeably in the first quarter. This was due exclusively to a steep fall in securitised lending by one bank owing to a change in business policy. By contrast, loans to the domestic private sector went up a little, although the year-on-year rise to end-March was no more than 1.1%. Besides the slack economic momentum – which *per se* is tending to dampen the demand for borrowing despite the favourable financing terms – this may also be attributable in part to a more cautious lending policy on the part of credit institutions: in a situation of narrow margins in lending business and a growing number of insolvencies (based on partial evidence), banks appear at the moment to be making stricter demands on borrowers' creditworthiness and collateral when granting new loans.

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

€ bn

Item	2002 Jan to Mar	2001 Jan to Mar
Deposits of domestic non-MFIs 1		
Overnight	– 17.1	– 1.2
With agreed maturities		
up to 2 years	– 12.3	+ 7.3
over 2 years	+ 7.3	+ 1.8
At agreed notice 2		
up to 3 months	+ 1.9	– 7.4
over 3 months	– 5.7	– 0.5
Lending		
To domestic enterprises and individuals		
Unsecuritised	– 5.9	+ 16.7
Securitised	– 12.3	+ 24.4
To domestic public authorities		
Unsecuritised	– 4.4	+ 4.0
Securitised	+ 3.3	– 12.9

***** 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. — **2** Savings deposits.

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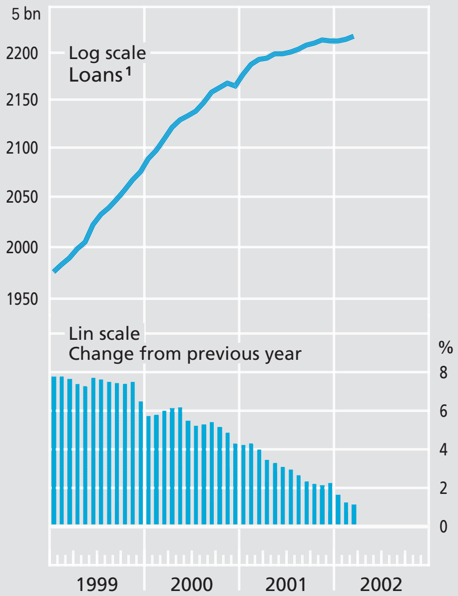
Lending by category of borrower

Looking at the main categories of private-sector borrowers in Germany, lending to individuals contracted slightly in the first quarter. Given the subdued cyclical trend and the re-

Loans to domestic enterprises and individuals

Seasonally adjusted



1 End-of-month level; adjusted for statistical changes.

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sulting greater income uncertainty, households' willingness to take up consumer loans had already dissipated by mid-2001. Enterprises, too, marginally reduced their indebtedness to German MFIs during the period under review. Above all, wholesale/retail traders and manufacturing firms cut their bank liabilities further. However, this was offset to some extent by an increase in lending to enterprises in the energy, gas and water supply sector and in the transport and communication sector. In the building industry, which overall remained in the doldrums, housing construction loans rose moderately between January and March, compared with a stagnant trend in the previous quarter.

Public sector borrowing

The indebtedness of domestic public authorities to German MFIs decreased by €1.1 billion in the first quarter of 2002. This compares with a drop of €8.9 billion in the same period in 2001, although that figure had been depressed by the redemption of equalisation claims on government, which are chiefly held by German MFIs. By contrast, domestic MFIs further boosted their portfolios of securities issued by German public authorities in the period under review (by €3.3 billion). Their unsecuritised loans showed a decrease of €4.4 billion, however, compared with an increase of €4.0 billion during the first three months last year.