Financial markets in Germany

Capital market and bank interest rates

Sharp fall in capital market interest rates

German capital market interest rates fell sharply over the past few months in line with US and European yields. The yield on ten-year Federal bonds outstanding in mid-August was just under 4½%, which was slightly more than ¾ percentage point lower than at the start of April. Interest rates on Federal securities with a shorter residual maturity showed a similarly steep decrease over the same period. On balance the interest rate discount on ten-year Federal bonds compared with the average rate of other European government bonds was unchanged at 19 basis points. By contrast, the interest rate spread of ten-year debt securities issued by domestic banks over comparable Federal bonds widened from 22 to 38 basis points during the period under review, although it remained at a comparatively low level.

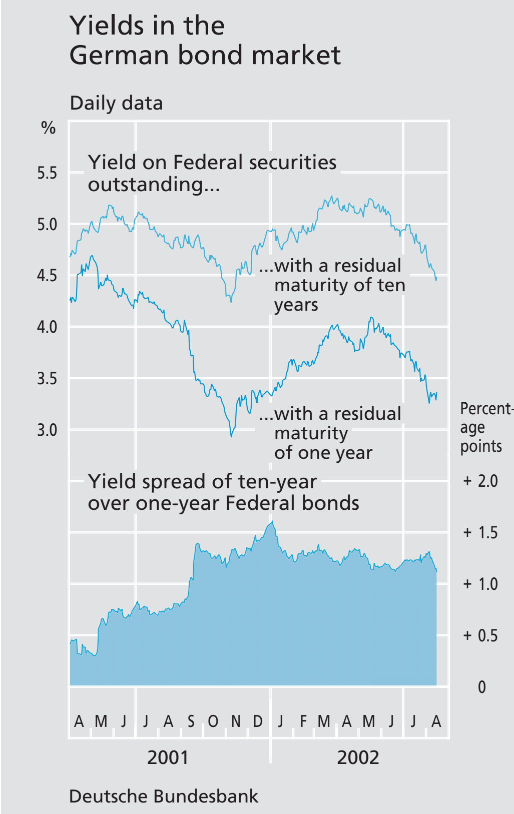
Little change in short-term bank rates, lower long-term rates

Whereas short-term bank interest rates, which are more strongly influenced by terms in the money market, showed little change between April and July, longer-term lending rates fell appreciably in parallel with capital market rates. The cost of mortgage loans at a rate of interest locked in for ten years decreased by just under ¼ percentage point on average to 6.1%. The effective interest rates for long-term fixed-rate loans to enterprises declined by a somewhat smaller margin. In July they stood at 6.7% (for a credit volume of €100,000 to less than €500,000) and 6.5% (for a credit volume of €500,000 to less than €5 million). However, the rate of 8.6% charged by banks in July for current account credit (for a credit volume of €500,000 to less than €2.5 million) was a few basis points more than in April. Interest rates charged on personal credit lines averaged almost 12.5% of late, which was the same as at the beginning of the period under review. On the liabilities side of the balance sheet, the interest rate paid in July on fixed-term deposits with a maturity of one month was 2.7% and on those with a maturity of three months 2.8% (for an investment amount of €50,000 to less than €500,000). These rates were similar to those paid in April.

Share prices

Plummeting share prices

Prices on the German equity market fell steeply over the past few months in tandem with developments on the international financial markets. In a very nervous trading environment the quotations of German equities plummeted by 34% between April and July to record their lowest level in five years. The slide in share prices on the Neuer Markt segment for new and growth stocks was even more dramatic. Since April the NEMAX all-share price index has plunged by almost 50%. The share prices of mid-cap enterprises listed on the MDAX held up somewhat better, losing around one-quarter of their stock market value. However, equity prices have recovered a little recently amid expectations of interest rate cuts in the United States and intensified efforts to restore the credibility of corporate balance sheets. In mid-August German equities were trading at 56% below their historical peak in March 2000 while quotations on the Neuer Markt were down by over 90%.



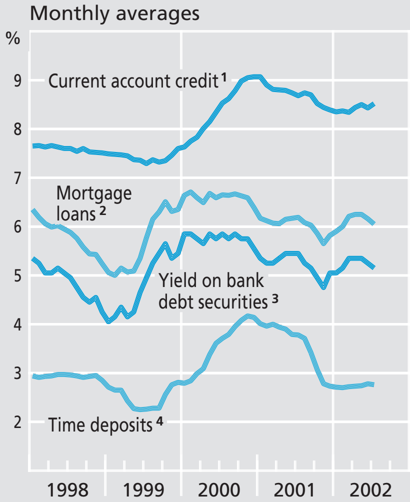
Borrowing in the securities markets

Bond sales

Sales activity in the German bond market contracted in the second quarter of 2002. Calculated at market prices, gross sales of debt securities issued by domestic borrowers amounted to €212½ billion (compared with €239½ billion in the previous quarter). Although redemptions and increases in issuers' holdings of their own bonds and notes also went down quarter on quarter, net sales of domestic debt securities decreased from €48½ billion in the first three months of this year to €36½ billion. The decrease related exclusively to longer-dated bonds, whereas sales of money market paper (with a maturity of up to one year) rose by €9 billion. Foreign bonds and notes were sold in the amount of €18½ billion, thus nearly matching the vol-

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, 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 €50,000 and more, but less than €500,000.

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ume recorded in the first quarter (€20 billion). As in the preceding months, most of them were denominated in euro (€18 billion). Total net sales of debt securities in the German bond market in the second quarter of 2002 thus came to €55 billion.

Slump in sales of bank bonds

The fall in borrowing was caused primarily by a sharp contraction of issuing activity by credit institutions, the refinancing requirements of which have declined owing to the drop in lending that has been apparent for quite some time (see page 27f). Between April and June banks raised only €9 billion net from selling their own debt securities, compared with €35 billion in the first quarter. The issuing activity of the institutions was concentrated on other debt securities (€10½ billion net). The outstanding market volume of debt securities issued by specialised credit institutions increased by €4½ billion. By contrast, the sale of mortgage *Pfandbriefe* yielded only €½ billion. The negative market trend in public *Pfandbriefe* which has persisted since the start of last year continued. In the second quarter of 2002 they were redeemed in the net amount of €6 billion. Government tapped the bond market from April to June for €21½ billion net, €13 billion of which accrued to central government. The Land governments raised a record sum of €11 billion from the sale of debt securities. They issued more short-dated paper (maturities of up to four years). The share of the latter in the total bonded debt of the federal states has gone up during the past two years from less than 5% to more than 16%. Despite the difficult earnings situation in the private business sector and the higher required yields, corporate bonds were sold in the second quarter for €5½ billion net, which was far more than in the first three months of this year (€½ billion).

Borrowing on the equity market

Issuing activity on the German equity market was subdued in the second quarter against the background of the persisting bear market. Between April and June domestic enterprises placed new shares with a market value of €2½ billion compared with €3½ billion in the first three months of the year. The net volume of foreign equities sold in the domestic market came to almost €16½ billion, so that the total amount of resources procured on the German stock market came to €19 billion.

Investment activity in the securities markets

Purchases of debt securities

Foreign investors were especially active in the German bond market in the second quarter of 2002; they purchased domestic debt securities for a total of €21 billion, which was substantially more than in the first three months (€2½ billion). The interest of domestic non-banks waned by contrast; their level of investment fell from €43½ billion in the first quarter to €18½ billion. Although the non-banks again bought foreign bonds and notes for €10½ billion, they added less than €8 billion worth of debt securities issued by domestic private sector borrowers to their portfolios; this contrasted with €32½ billion net in the preceding quarter. The credit institutions increased their bond holdings by €16 billion. Their interest focused on public debt securities (€9 billion) and foreign bonds and notes (€8 billion).

Purchases of shares

In the second quarter German equities were largely bought by domestic non-banks on balance. In net terms they invested exclusively in foreign equities, in the amount of €17 billion. Foreign shareholders invested €11 billion in the German share market compared with €9 billion between January and March. During the period under review domestic credit institutions resold foreign equities worth almost €6 billion and €3½ billion of German shares.

Investment fund certificates

Sales of domestic and foreign investment fund certificates declined to €18½ billion in the second quarter, compared with €26 billion in the first three months of this year. Between April and June domestic investment companies issued certificates for €15½ billion net (previous quarter: €18½ billion); foreign investment fund certificates were sold in the amount of €3 billion.

Investment activity in the German securities markets

€ bn

Item	2002 Jan to March	2002 April to June	2001 April to June
Bonds and notes			
Residents	66.0	34.2	40.6
Credit institutions 1	22.3	15.9	23.1
of which Foreign bonds and notes 2	9.1	8.1	0.2
Non-banks	43.6	18.3	17.5
of which Domestic bonds and notes	28.6	7.8	– 8.4
Non-residents 2	2.4	21.0	– 1.4
Shares			
Residents	10.4	8.0	– 17.9
Credit institutions 1	– 8.6	– 9.1	– 26.1
of which Domestic shares	– 5.4	– 3.4	– 28.4
Non-banks 3	18.9	17.2	8.1
of which Domestic shares	0.1	– 4.8	– 40.1
Non-residents 2	8.9	10.8	71.4
Investment fund certificates			
Investment in specialised funds	5.0	11.1	2.9
Investment in funds open to the general public	13.7	4.6	5.6
of which: Share-based funds	1.0	1.0	2.0

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

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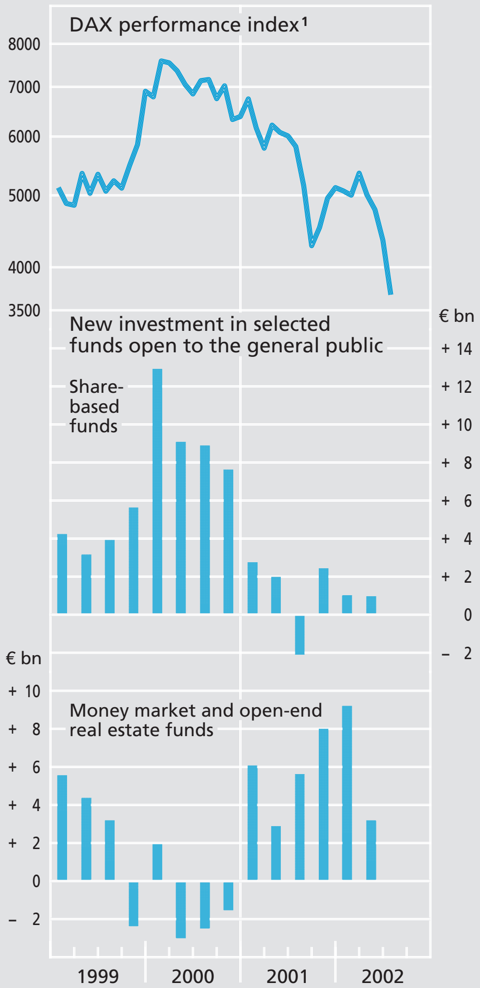
Savers with mutual funds showing restraint and caution

The domestic investment funds open to the general public sold certificates worth €4½ billion net in the second quarter, which fell far short of the first-quarter total (€13½ billion). Savers with mutual funds continued to heavily favour open-end real estate funds, which raised €3½ billion. The popularity of such funds, which has persisted since last year, has now made them the second most popular category of funds open to the general public after share-based mutual funds, with a volume of currently €68½ billion. One reason for this success is doubtless that real estate funds

Equity prices and selected investment in funds



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

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appear especially attractive given the present state of the stock market. In the second quarter of 2002 €1 billion again accrued to share-based mutual funds, while mixed funds likewise received only €1 billion of new investment. All other types of fund recorded only marginal changes. Between April and June the inflow of resources to the domestic special funds, which manage monies invested by institutional customers, was up on the three preceding months, amounting to just over €11 billion. On balance the bulk of this sum was invested in mixed securities funds (€7½ billion). Foreign investors returned fund units in the amount of €1 billion.

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

Steep rise in overnight deposits

In the second quarter of 2002 the overnight deposits placed by domestic customers with German MFIs again rose steeply (measured on a seasonally adjusted basis) after their growth had weakened perceptibly in the first three months of this year. They increased vis-à-vis the previous quarter at a seasonally adjusted annualised rate of 18½% as against just over 7% from January to March. Other financial institutions and especially employed persons accumulated overnight deposits on a large scale. Their growth was also fuelled by the conversion at one large credit institution of short-term savings deposits into overnight deposits remunerated at money market rates. The pronounced liquidity preference of private non-banks presumably reflects above all the increased uncertainty on the financial markets, which, measured by the DAX volatility index, at the end of June regained the level seen in October/November 2001.

Rise, too, in short-term time deposits...

Domestic investors also increased their deposits with an agreed maturity of up to two years during the second quarter of 2002, after having run them down on a massive scale in the first three months. This reversal mainly mirrors a change in conduct on the part of German insurance companies which, contrary to the normal pattern, increased their short-term time deposits in the second quarter and decreased their longer-term time deposits. The slight narrowing of the interest rate spread of longer-term over short-term deposits at banks probably reinforced the insurance corporations' preference for liquidity.

... and in longer-term time deposits

Although German insurance companies are the principal investors in deposits with an agreed maturity of more than two years, with a share of around 60%, longer-term time deposits grew by a further €0.8 billion in the second quarter; this rise was chiefly attributable to employed persons.

Fall in savings deposits

In the period from April to June 2002 savings deposits with an agreed period of notice of up to three months declined noticeably owing to the aforementioned conversion of short-term savings deposits into overnight deposits. If this switch is disregarded, short-term savings deposits were again in demand. Given the very low short-term interest rates at the moment, short-term savings have a fairly low opportunity cost compared with investment instruments remunerated at market rates. The contraction of deposits with an agreed notice of over three months continued during the period under review, albeit at a decelerating pace (by €3.2 billion).

Persistently weak lending to the private sector

Seasonally adjusted lending by German MFIs to the domestic private sector again showed only muted growth in the second quarter. This applies particularly to unsecuritised lending. Although medium to long-term loans to German enterprises and households went up moderately during the period under consideration, the volume of short-term loans again dropped markedly. At the end of June loans to the private sector in Germany were only marginally higher than in the same month last year. Besides dampening cyclical influences on the demand for credit from the domestic private sector, this restrained expansion was probably due in part to banks' reduced willingness to grant loans on account of the deteriorating creditworthiness of at least some borrowers and deficient collateral cover.

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

€ bn

Item	2002 April to June	2001 April to June
Deposits of domestic non-MFIs 1		
Overnight	+ 28.1	+ 21.0
With agreed maturities		
up to 2 years	+ 0.6	+ 1.8
over 2 years	+ 0.8	+ 2.3
At agreed notice 2		
up to 3 months	− 8.7	− 2.9
over 3 months	− 3.2	− 4.0
Lending		
To domestic enterprises and individuals		
Unsecuritised	+ 3.8	+ 6.9
Securitised	− 3.6	− 22.7
To domestic public authorities		
Unsecuritised	− 14.2	− 13.2
Securitised	+ 9.4	+ 2.6

* 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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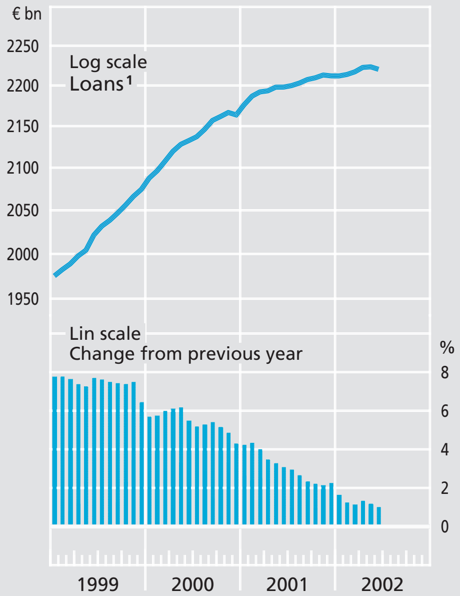
Lending by category of borrower

The ongoing sluggish trend in lending to the domestic private sector in the second quarter of 2002 chiefly reflects the fall-off in lending to German enterprises. Whereas both consumer and housing loans rose slightly, the extension of credit by German banks to domes-

Loans to domestic enterprises and individuals

Seasonally adjusted



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

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tic enterprises shrank perceptibly. This contraction occurred in virtually every industrial sector. In the case of manufacturing firms, wholesale/retail traders and construction companies the reduction of debt evident since the start of 2001 continued. In the period under review insurance companies and financial institutions as well as transport and communication enterprises likewise curtailed their indebtedness to domestic banks. Only the services sector and the energy, gas and water supply industries stepped up their debt level.

Public sector borrowing down

Net borrowing by German public authorities from domestic MFIs decreased in the second quarter of 2002 by a total of €4.8 billion. At the same stage last year it had fallen by as much as €10.6 billion. Loans were reduced by a substantial €14.2 billion in the period under review as both central and state government cut their debt to German banks. By contrast, domestic MFIs further boosted their portfolios of securities issued by German public authorities between April and June by €9.4 billion.