The financial markets in Germany

Capital market and bank interest rates

Persistently small "yield advantage" of Federal bonds over bonds of other euro-area countries ...

German capital market rates fluctuated during the summer and autumn months, rising by slightly more than ½ percentage point to just under 4½% – in line with euro-area interest rates. In the period under review, the average interest rate discount on ten-year Federal bonds was just under 1⁄10 percentage point below the average of other European government bonds. At least some of the narrowing of the "yield advantage" of Federal bonds in the euro capital market was presumably due to the tense budgetary situation. The yield advantage of ten-year bank bonds over comparable Federal bonds should also be viewed in this light; at the time of going to press, it was just under 16 basis points down on the average in previous years.

... and over bank bonds

Further slight decline in short-term bank rates

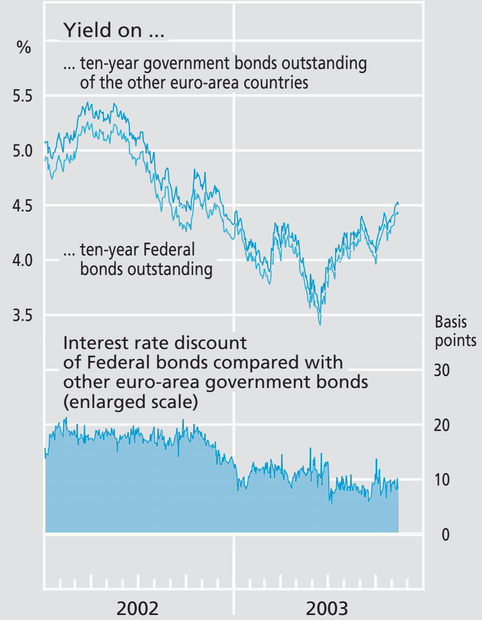
The carry-over effects of the key interest rate reduction in early June this year left their mark on bank rates, particularly those on shorter-term loans and deposits. At all events, the new euro-area MFI interest rate statistics produced a further slight decline in short-term bank rates in the third quarter. Among short-term deposits, interest rates on households' deposits with agreed maturities of up to one year fell by roughly ¼ percentage point to below 2%. By contrast, the rates of interest on short-term time deposits of non-financial enterprises did not evolve uniformly. The earlier reduction in the key interest rate was also still affecting banks' short-term lending business. Households, in particular, were able to take advantage of housing loans with an initial interest rate fixation of up to one year. The interest rate charged by banks on this type of loan shrank from 5.0% in June to 4.6% in September. Furthermore, the interest rates on household consumer credit also went down across the entire range of maturities. By contrast, in the field of lending to enterprises, the only real decline was in the rates charged on overdrafts; between June and September 2003 these went down by 0.2 percentage point to 6.4%. It needs to be borne in mind that, in terms of the associated risks, this credit category is far more heterogeneous than the aforementioned housing loans. The interest rates on new corporate loans agreed by banks thus depend not only on general interest rate developments but also, to a greater extent, on the borrower's risk rating.

Increase in some longer-term bank rates

Some longer-term bank rates went up in line with the increase in capital market rates, which rose as the economic outlook improved. In particular, the rates charged on loans to non-financial enterprises with a credit volume of more than €1 million and an interest rate fixation of more than five years went up by ½ percentage point to 4.7%. The bank rates charged for smaller-volume corporate credit developed unevenly across the sector, a fact which should probably also be seen as connected with risk assessment. The average rates charged on housing loans with an initial interest rate fixation of more than one year rose by an average of just under 0.2 percentage point, particularly after the increase in capital market rates which took place in late summer.

Interest rate discount of Federal bonds in the euro-area bond market

Daily data



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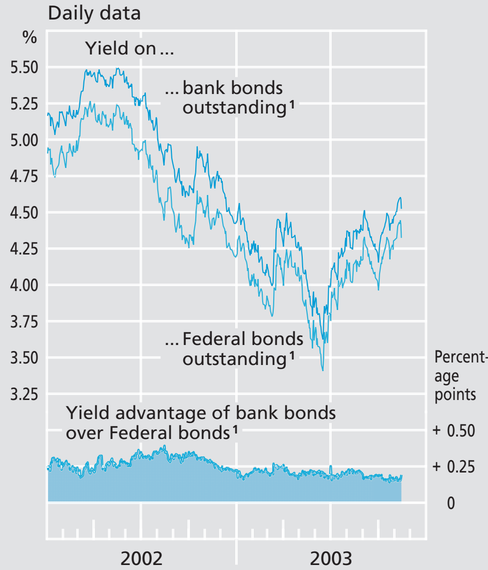
Borrowing in the securities markets

Bond sales subdued

Fewer funds were raised in the German bond market in the third quarter of 2003 than in the preceding quarter. Although domestic borrowers issued €275 billion worth of debt securities in both the second and third quarters, a greater number of redemptions and changes in issuers' holdings of their own paper resulted in net sales amounting to only €20 billion in the period under review – as opposed to €27½ billion in the previous three-month period. Far fewer foreign bonds (€4½ billion) were sold in Germany in the third quarter than in the previous quarter (€19 billion). Hence the overall amount of funds raised (€24½ billion) was only half as much as in the preceding quarter.

Bond market valuation of German financial institutions

Daily data



1 With mean residual maturities of more than nine years up to and including ten years.

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Increase in sales of bank bonds

In the second quarter sales had been mainly of public bonds; between July and September bank debt securities were again the front runners. In that period, German credit institutions raised €9½ billion in the bond market. There was a continuation of the multi-year trend away from public Pfandbriefe (-€7 billion in this quarter) towards debt securities issued by specialised credit institutions (+€11½ billion). Issues of other bank bonds raised €3½ billion net and issues of mortgage Pfandbriefe raised €2 billion net.

Decline in issues of public bonds

The public sector upped its bond market debt by €9 billion in the third quarter, from €17 billion in the previous quarter. Apart from the fact that the Federal Government raised fewer funds in the market (€12½ billion), this was mainly due to distinctly reduced borrowing by the state governments (*Länder*). Following record figures of €13 billion and €11 billion in the previous two quarters, only €2½ billion net worth of state government bonds were sold in the third quarter of 2003. Of Federal Government debt securities, the greatest demand was for ten-year bonds (€7½ billion), followed by 30-year bonds (€4 billion) and Federal Treasury notes (€2½ billion). On balance, €6 billion worth of five-year Federal notes (Bobls) were redeemed, as was a €5 billion debt security issued by the Treuhand agency. This borrower no longer issues debt securities in its own name but in conjunction with the Federal Government.

Decline in sales of corporate bonds

There was a marked decline in sales of corporate bonds (€1½ billion) between July and September 2003 (previous quarter: €8 billion). Issuing activity was particularly buoyant in the first half of the year, resulting in an overall year-on-year increase of almost 45% in the volume outstanding of corporate bonds and commercial paper issued by domestic non-banks. This indicates that the importance of these financing instruments is growing.

Few funds raised in the equity market

After a temporary increase in spring, German equity market issues slowed again. In the third quarter of 2003, domestic shares were issued to a market value of €2 billion; two-thirds of these shares were unlisted. The equity market recovery and the associated improvement in financing opportunities were thus not yet being reflected in greater recourse to this financing channel.

New MFI interest rate statistics

The new MFI (monetary financial institutions) interest rate statistics have been collected in a uniform manner in all euro-area countries since January 2003. The German results include data submitted by a representative sample of around 200 banks, with all interest rates being weighted with the respective lending or deposit volumes. The new MFI interest rate statistics supersede the Bundesbank's statistics on lending and deposit rates, which were discontinued after June 2003. The old method recorded the unweighted interest rates on new business in standardised deposit and lending products most frequently agreed by German banks with their retail customers. The results produced by the two methods are extremely difficult to compare because the new MFI interest rate statistics are conceptually very different from the previous statistics.

The German contribution to the MFI interest rate statistics covers the interest rates applied by MFIs in Germany and the related volumes of euro-denominated deposits and loans to households and non-finanical corporations domiciled in the euro area. The lending and deposit categories were redefined and harmonised in order to represent the new business of all euro-area banks adequately.

The MFI interest rate statistics include not only interest rates and volumes of new business but also the corresponding data for outstanding amounts by lending and deposit category; for the latter, the end of the month is the cut-off date. When the books are closed at the end of the month, reporting institutions calculate the effective interest rates and volumes of all outstanding deposit and lending business and calculate a weighted average interest rate for each reporting category.

Banks use two different procedures for capturing new business. In the case of deposits with an agreed maturity and of all loans excluding overdrafts, new business encompasses all new agreements between customers and banks. These include all financial arrangements in which terms have been agreed for the first time in the reporting month as well as all outstanding contracts newly negotiated with active involvement by the customers. The interest rates are calculated as volume-weighted average rates, with account being taken of all new agreements concluded during the reporting month. In the case of overnight deposits, deposits redeemable at notice and overdrafts, however, new business is collected (like outstanding amounts) at the end of the month in question.

Effective interest rates are calculated either as annualised agreed rates or as narrowly defined effective rates, which cover interest payments but no other related costs (such as for enquiries, administration, preparation of documents, guarantees and credit insurance). In addition, for the overarching categories of "consumer credit" and "housing loans" to households, the annual percentage rate of charge as defined in Directive 87/102/EEC, which comprises the total costs to the customer, is also to be reported.

A more comprehensive introduction to the new MFI interest rate statistics will probably be published in a forthcoming edition of the Bundesbank's *Monthly Report.* Further information on the new interest rate statistics can be found on the Bundesbank's website (www.bundesbank.de, under Statistics/Reporting system/Banking statistics/EWU-Zinsstatistik). Not all of this information is available in English yet.

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Investment activity in the German securities markets

€ billion

Item	2003 Apr to June	2003 July to Sep	2002 July to Sep
Bonds and notes			
Residents	22.8	30.9	25.1
Credit institutions	3.2	4.0	– 5.0
of which			
Foreign bonds and notes	10.1	0.2	6.5
Non-banks	19.6	27.0	30.1
of which			
Domestic bonds and notes	10.6	22.6	23.2
Non-residents	23.7	– 6.2	41.0
Shares			
Residents	6.2	1.2	3.9
Credit institutions	5.5	– 1.5	– 5.6
of which			
Domestic shares	0.2	0.0	– 4.2
Non-banks	0.7	2.7	9.5
of which			
Domestic shares	2.9	– 1.3	6.0
Non-residents	2.5	3.4	– 0.1
Mutual fund shares			
Investment in specialised funds	6.8	4.0	7.4
Investment in funds open to the general public	7.0	2.6	4.6
of which: Share-based funds	2.0	0.3	– 0.5

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Investment activity in the securities markets

Bonds and notes purchased mainly by non-banks

Non-banks were the main purchasers in the German bond market in the third quarter of 2003. They added €27 billion to their bond portfolios. Public debt securities accounted for most of this figure (€18 billion). Domestic credit institutions purchased €4 billion worth of debt securities. On balance, their purchases comprised almost exclusively bank bonds. By contrast, foreign investors sold €6 billion net worth of German debt securities. The vast majority of these were public debt securities.

Share purchases constant

Purchases by non-banks also determined the shape of things in the equity market. Investors from that sector purchased €2½ billion net of equities, all of which were foreign equities. By contrast, domestic credit institutions parted with €1½ billion worth of equities. Foreign investors added €3½ billion to their portfolios of German shares.

Decline in investment in mutual fund shares

The third quarter saw a further decline in investment in mutual fund shares, from €14 billion in the preceding period to €7 billion. Purchases were mainly effected by institutional investors, which invested €4 billion net in the specialised funds tailored to their investment needs. By contrast, only €2½ billion was raised from sales accruing to mutual funds open to the general public. Private investors continued to focus on open-end real estate funds (which are considered particularly safe), followed by mixed funds and bond-based funds. Money market funds, however, had to cope with outflows; their volume declined by €1 billion.

Share prices

Strong price increases in the German equity market

On balance, German equity market prices rose far more sharply in the third quarter than European or US equity prices. However, the earlier downturn in German equity market prices had also been more pronounced than in the other two markets. Even after the latest increase, German equity prices were still more than 50% below their March 2000 peak. Between July and mid-November 2003 the broad market index for German equities (CDAX) gained slightly less than 20%, compared with a mere 13% increase for the Dow Jones EuroStoxx price index and just under 8% for the US S&P 500 index. The German index initially continued its dynamic upward trend until mid-September. Subsequently, however, there was a temporary marked slide of over 10% – triggered by doubts about the sustainability of the price upswing – before prices began to rise again.

No change in valuation level of German shares

The 28% increase in the value of German equities in the course of the year, which was likewise greater than that of European or US shares, also has to be viewed against the backdrop of a gradual improvement in the economic outlook for Germany and the stronger increase in profit expectations compared with the other euro-area countries. For instance, the year-on-year profit expectations for the equities in the German share index (DAX) improved by nearly 11% between April and October while for the Dow Jones EuroStoxx index an increase of only just under 4% was expected.[1] Despite price gains in the third quarter, the valuation level of German shares thus remained virtually constant over the past few months. Based on the expected earnings for the next 12 months, the average price-earnings ratio was 15.2, ie somewhat higher than for the Dow-Jones EuroStoxx price index (14.7). The current valuation level is comparable with the average DAX price-earnings ratio of 15.5 between 1990 and the start of the equity upswing in 1997. When the share price increase reached its peak in 2000, values were occasionally as high as 30.

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

€ billion

Item	2003 July to Sep	2002 July to Sep
Deposits of domestic non-MFIs [1]		
Overnight	– 0.8	+ 4.3
With agreed maturities		
up to 2 years	– 12.0	– 6.2
over 2 years	+ 9.5	– 0.6
At agreed notice		
up to 3 months	+ 5.8	– 0.4
over 3 months	– 4.2	– 0.2
Lending		
to domestic enterprises and households		
Unsecuritised	+ 6.6	+ 8.1
Securitised	– 3.2	+ 3.9
to domestic government		
Unsecuritised	+ 0.6	– 4.7
Securitised	– 3.0	+ 7.5

* 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 IV1 in the Statistical Section of the *Monthly Report*. — **1** Enterprises, households and government.

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

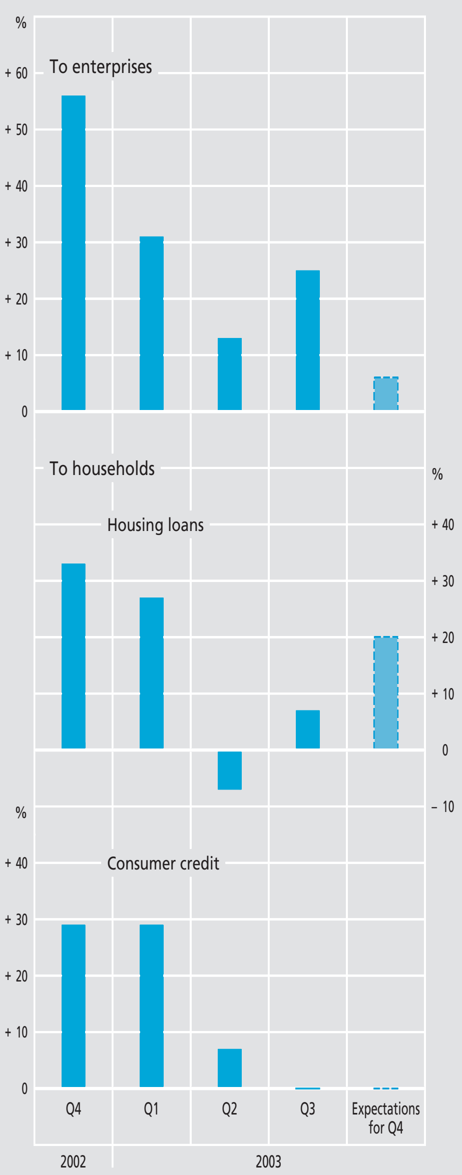
Further sharp increase in overnight deposits

Overnight deposits placed by domestic customers with German MFIs again rose sharply in the third quarter of 2003. In the period under review, households, in particular, built up their overnight deposits more strongly than is otherwise usual between July and September. However, compared with the previous two quarters, there was a further perceptible easing of the pace at which the overnight deposits of domestic non-banks were expanded. The seasonally adjusted and annualised growth rate decreased from 15½% at the end of June to 10% at the end of Sep-

1 I/B/E/S analysts' estimates.

Bank lending survey
Wider risk-differentiated margin spread

Changes in the credit standards applied to the approval of loans or credit lines[1]



1 Difference between the sum of the percentages for "tightened considerably" and "tightened somewhat" and the sum of the percentages for "eased somewhat" and "eased considerably". — 2 See Deutsche Bundesbank, German results of euro-area bank lending sur-

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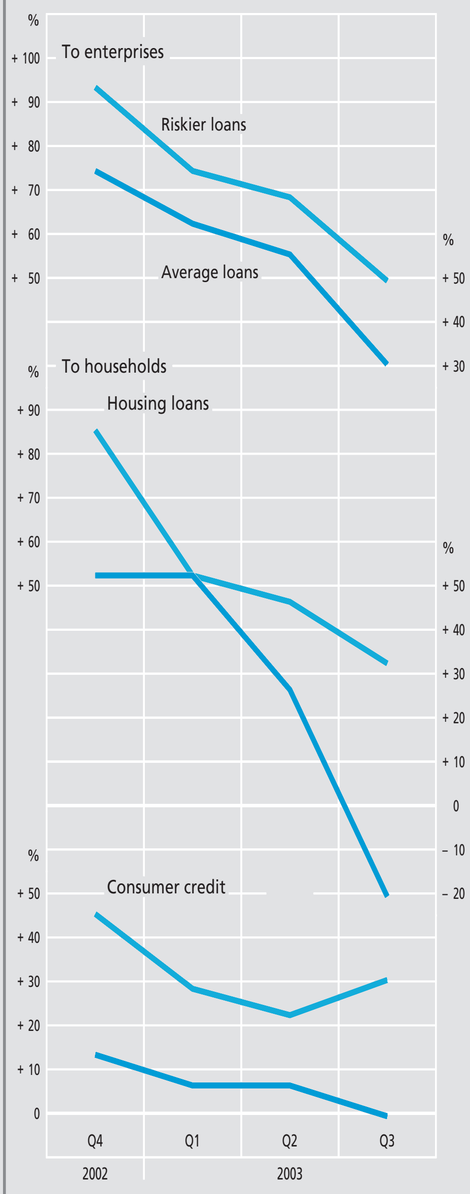
According to the results of the Eurosystem's fourth bank lending survey,[2] the respondent institutions in Germany continued to tighten slightly their credit standards as applied to some loans and credit lines to enterprises in the third quarter of 2003. This was unrelated to the size of the enterprises or the loan maturity. Essentially, the credit institutions again pointed to higher risk assessment as the cause, especially given the general economic outlook and sector-specific or company-specific factors; however, the responses suggested that, to an extent, increases in banks' cost of capital had also played a role. For housing loans and household consumer credit, however, the credit standards remained largely unchanged in the third quarter of 2003. The institutions do not expect substantial changes in their credit standards for loans to enterprises or for consumer credit in the fourth quarter of 2003, although a slight tightening is evident for housing loans (see adjacent chart).

The trend towards a sustained broadening of margins for riskier loans continued in all areas of credit business covered by the survey, indicating a wider risk-differentiated spread of banks' loan margins (see chart on page 31). During the past quarters, there was a steady decline, however, in the tendency for the margins on average loans to widen; in the case of housing loans, the data supplied by the banks in the third quarter suggest that, to an extent, there was actually a narrowing of the margins on average loans. With regard to the other lending conditions, the respondent banks also indicated that they were applying somewhat stricter criteria to loans or credit lines to enterprises – partly in respect of credit volume but also of collateral.

According to the survey, there was a further slight decrease in loan demand from enterprises, whereas for consumer credit the demand was unchanged and for housing loans to households it was edging slightly upwards. According to the data supplied by the respondents, the main factor contributing to the further slight reduction in loan demand from enterprises was lower financing needs for fixed investment, whereas debt restructuring again generated positive demand effects. With regard to households, uncertainty as to the future of the government grant to home buyers among other things increased demand for housing loans. Depressed consumer confidence was meanwhile still having a dampening effect, although this was not as strong as it had been. Compared with the aggregate results for the euro area, the replies from the respondent German institutions more frequently express expectations of an increase in loan demand from both enterprises and households in the fourth quarter. Overall, however, the German survey results were more or less in line with the aggregate results for the euro area.[3]

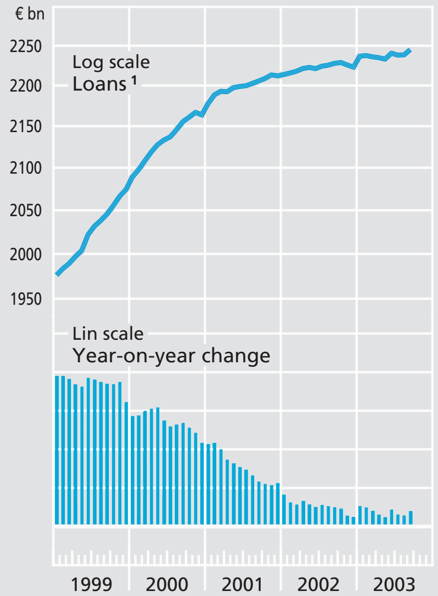
Changes in loan margins[1]



vey, *Monthly Report*, June 2003, pp 67-76. — **3** See European Central Bank, *Monthly Bulletin*, November 2003, pp 13-15.

Loans to domestic enterprises and households

Seasonally adjusted



1 End of month; adjusted for statistical changes.

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tember. In addition to the share market recovery, the normalisation of the bond market situation is likely to have been a contributory factor here; the situation had encouraged liquidity holding, particularly in the previous quarter.

Sharp increase in short-term savings deposits ...

In the period under review, there was also a marked expansion in deposits with an agreed period of notice of three months. The bulk of the increase was clearly attributable to special savings forms with a higher rate of interest. However, savings deposits with a comparably low minimum or basic rate of interest also picked up in the past three months. All in all, savings deposits with an agreed period of notice of three months seem to have become more attractive to investors of late – especially compared with deposits with an agreed maturity of up to two years. Correspondingly, short-term time deposits were reduced sharply in the period under review. However, this was brought about not only by households but also by domestic government, which had built up fairly large volumes of such deposits in the previous quarter.

... and marked reduction in short-term time deposits

Marked increase in longer-term bank deposits

In seasonally adjusted terms, there was a marked increase in longer-term bank deposits in the period under review. This increase was solely in deposits with maturities of more than two years, which came mainly from insurance corporations. In the previous quarter, insurance corporations, which are traditionally the most important group of investors for this type of deposits, had made perceptible cuts in their longer-term time deposits. Deposits with an agreed period of notice of more than three months were reduced further in the third quarter. They thus continued their trend decline, which has been under way since spring 2001 and which even accelerated further of late.

Lending to the private sector

In seasonally adjusted terms, there was again only a slight expansion in loans by German MFIs to the domestic private sector between July and September. The increase was roughly equally spread over securitised and unsecuritised lending. Overall, the third-quarter increase in unsecuritised lending to German enterprises and households was similar in scale to that of the previous quarter, even though growth was slower for medium to long-term unsecuritised lending. As an annualised figure, unsecuritised lending to the private sector in Germany went up at a seasonally adjusted rate of just under 1%. Again, weak economic growth in Germany is likely to have been the main factor behind this minor increase in lending. Moreover, the latest results of the Bank Lending Survey indicate that banks have again been tightening their lending conditions slightly (see box entitled "Bank lending survey" on pages 30-31).

Lending, by borrower

Lending to the domestic private sector was curbed mainly by the ongoing decline in unsecuritised lending to enterprises and self-employed persons. In addition to wholesale and retail traders, manufacturing and construction enterprises also reduced their borrowing from German banks again. Borrowing by the services sector continued the downward trend that it has now been pursuing for a year. By contrast, employees increased their borrowing from German banks again in the period under review, after having reduced it slightly in the previous quarter. However, housing loans were again the principal mainstay of domestic lending business. There was a further expansion of medium to long-term lending, in particular. The low interest rate charged on mortgage loans probably also played a role in this development.

Lending to the public sector

Lending to the public sector in the third quarter decreased by €2.4 billion net. This was due solely to the reduction in banks' portfolios of securities issued by the public sector (-€3.0 billion). By contrast, banks increased their unsecuritised lending to public sector borrowers in Germany by €0.6 billion.