Financial markets

Financial market setting

Financial market trends

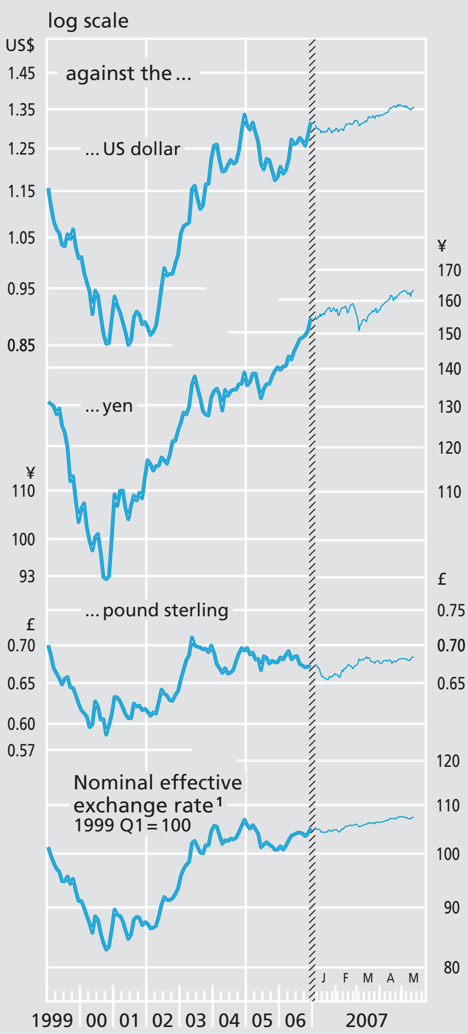
The revised assessments of the growth outlook for Europe and the USA were a key factor determining developments in the international financial markets during the first few months of 2007. While exceptionally positive economic data and firmly anchored inflation expectations played a role in the euro area, fears of a crisis in the US housing market and occasionally emerging concerns about inflation had a marked effect especially on the US bond market. Following the corrections associated with the – temporary – slump in the Chinese stock market, the financial markets on both sides of the Atlantic very soon regained their momentum and, in many cases, were achieving multi-year – or even record – highs at the end of the reporting period. In the wake of the improved cyclical outlook for the euro area, existing expectations of higher interest rates became firmer. While the markets no longer expect interest rates in Japan to be hiked soon, many players are, in fact, expecting interest rate cuts for the United States. Given this situation, the euro appreciated markedly – especially against the US dollar and the yen – during the reporting period and, at times, was trading at new all-time highs.

Exchange rates

The euro's exchange rate against the US dollar, ...

The upward movement of the euro-US dollar exchange rate started in mid-February, when it became clear, following the publication of favourable economic data, that the euro-area economy would be growing more strongly

Exchange rate of the euro



* Monthly averages; from 2007, daily values. — 1 As calculated by the ECB against the currencies of 24 countries.

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this year than previously expected. At the same time, there were increasing negative reports on the economy for the United States, and the Federal Reserve made a downward adjustment to its growth forecast for the current year. However, the problems in the US mortgage market – the scale and implications of which could not be reliably assessed by market players – were also placing a strain on the US dollar.

The trend appreciation of the euro against the US dollar persisted, with only brief and limited interruptions, up to the end of April. The single currency was strengthened by the expectation of rising euro interest rates and a marked narrowing of the interest rate spread against long-term assets denominated in US dollar. The increase in key Eurosystem interest rates in early March had been expected by the markets and therefore had no identifiable direct impact on the euro-US dollar exchange rate. When it finally became known that the US GDP growth rate in the first quarter of 2007 had been lower than expected, the euro hit a new record high at the end of April at just over US$1.36.[1] As this report went to press, the exchange rate was virtually unchanged at just under US$1.36, 3% up since the beginning of the year.

... against the yen ...

The euro also appreciated substantially against the yen. Following a brief decline in the euro-yen exchange rate in January, the euro already began to appreciate against the yen again in February, reaching an interim record high of ¥159. The upward movement was interrupted abruptly in the first week of March, however, when the euro, under downward pressure with the worldwide slump in stock market prices, fell to ¥151. Many market players cite the heightened uncertainty in the financial markets, which dampened risk propensity during this period

1 However, measured by the DM-US dollar exchange rate, the US dollar, at DEM1.3620 on 19 April 1995, was trading even lower. At the conversion rate of DEM1.95583/€1, the present euro-US dollar peak of US$1.3649 corresponds to a DM-US dollar exchange rate of DEM1.43/US$1.

and led to a reversal of carry trades, as the reason for the temporary surge of the yen.

However, the euro made up its losses against the yen again as early as mid-March after the situation in the financial markets had become somewhat calmer and additional increases in euro-area interest rates had been under discussion in the market following the ECB's generally expected interest rate move. Speculation about an increase in the yield spread of European assets over Japanese assets pushed the euro-yen exchange rate up to just below ¥164 – a new record – by mid-May. The euro was thus nearly 4½% higher than at the beginning of the year.

... and against the pound sterling

The publication of the minutes of the Bank von England's Monetary Policy Committee meeting, which showed that the surprising key interest rate increase in January was decided only by a small majority, dampened expectations of further interest rate moves by the Bank of England at the end of January. As a result, the euro appreciated against the pound sterling, rising to £0.69 by mid-March. Since then, it has been trading without a clearly identifiable trend at around £0.68 and, at the end of the period under review, was roughly 2% up on its level at the start of the year. Given that the Bank of England had, for the first time, just failed to meet its inflation target band, the key interest rate hike in May had been generally expected and therefore had no noticeable impact on the euro-sterling exchange rate.

In the period under review, the euro appreciated against the average of the currencies of 24 major trading partners. As this report went to press, the effective exchange rate was 2% up from the beginning of the year and just under 4½% above its level at the launch of monetary union. In real terms, ie taking account of the concurrent inflation differentials between the euro area and the major trading partners, the euro's effective exchange rate – which is a measure of euro-area sellers' price competitiveness – was more than 5% higher than at the start of monetary union.

Effective exchange rate of the euro

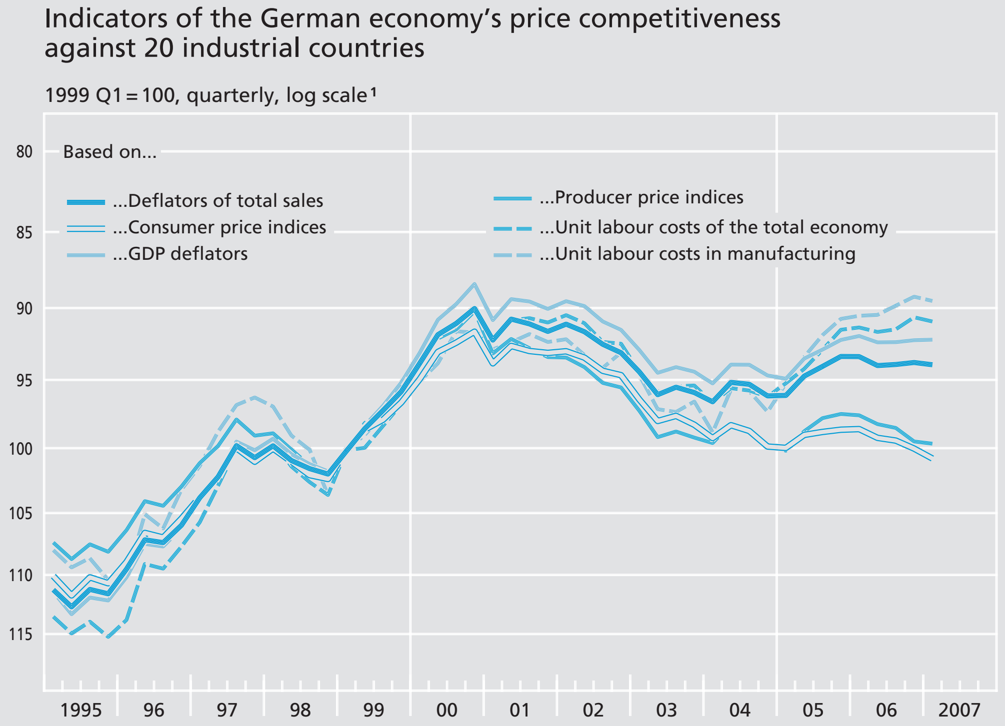
New and recalculated indicators of the German economy's price competitiveness

The Bundesbank regularly calculates and publishes indicators of the German economy's price competitiveness, which reflect price and cost developments in Germany in comparison with a weighted average of Germany's trading partners.[2] Conceptually, these indicators correspond to real effective exchange rates such as those calculated by the ECB for the euro. Up to now, the Bundesbank has focused its assessment of price competitiveness on indicators which have been calculated against a narrow group of 19 industrial countries or against a broad group of 49 trading partners.

Modified calculation method

The method of calculating competitiveness indicators has now been modified in several respects. First, seven additional trading partners have been included in the broad group of countries, which now comprises *inter alia* all the EU and OECD countries. Second, for the narrower groups, the method of comput-

2 See, for example, Table XI, 13 in the Statistical Section of the Monthly Report.



1 Inverted scale: rise of curve (decline in values) denotes increase in price competitiveness.

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ing the trade weights at which the individual partner countries are included in the indicator has been modified slightly. The weights are now determined by simply rescaling the corresponding weights calculated for the broad group of countries.[3] This method simplifies the calculations and reduces potential biases such as those mentioned in the study by Buldorini et al.[4] Third, the indicators are now calculated using weights which are adjusted over time to the changing trade flows. The new weights are based for all indicator series up to 1998 on data from the period 1995 to 1997 and, from 1999, on data from the period 1999 to 2001. Despite the numerous modifications, the differences between the old and recalculated indicators, however, are slight.

Indicators against a narrow group of countries

A further innovation specifically concerns the composition of the narrow group of countries: Slovenia has been added to this group from 2007 to take account of its accession to the euro area. From this date, the relevant indicator values are therefore calculated against 20 trading partners, while earlier values are still calculated against the 19 countries defined previously. This will allow this indicator to continue to be split into two subindicators in future, ie a subindicator against the group of euro-area countries (in which nominal exchange rate movements are irrelevant) and a

3 The method of calculating the weights for the broad group of countries is described in L Buldorini, S Makrydakis and C Thimann (2002), The effective exchange rates of the euro, ECB Occasional Paper No 2.
4 See Buldorini et al, loc cit, p 15.

subindicator against the group of non-euro-area countries.[5]

Indicators based on additional price and cost indices

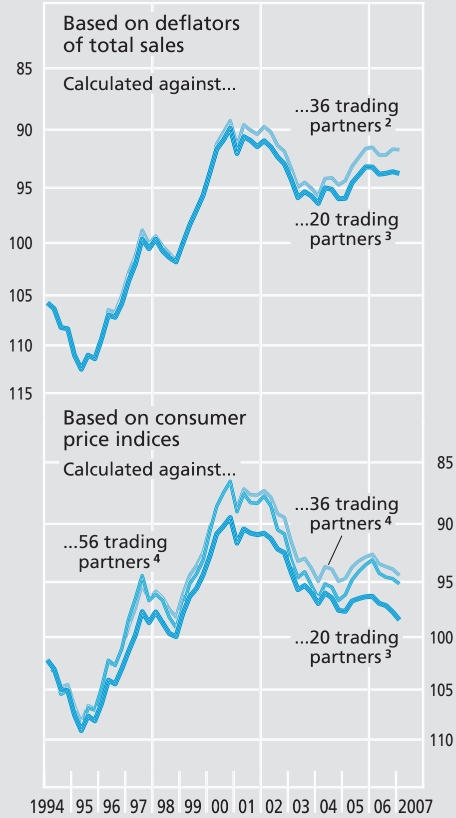
Furthermore, additional indicators of the German economy's price competitiveness are now being calculated in quite another respect. The range of price and cost indices used as a basis for calculating the indicators has been expanded to include GDP deflators and unit labour costs of the economy as a whole, for example. A comparison of the various indicators calculated using different price and cost indices shows, however, that the German economy's price competitiveness is assessed quite similarly using most of the indicators. This enhances the robustness of the conclusions drawn from them.

Consumer price indices compared with deflators of total sales

What is striking, however, is that, since the turn of the millennium, the gap between an indicator calculated on the basis of consumer prices and an indicator computed using deflators of total sales has widened steadily, even though these two series were very closely correlated in the preceding decade. Unlike for Germany's trading partners, macroeconomic deflators for Germany, such as the one used here or the GDP deflator, do indeed show a noticeably lower rate of inflation for Germany during the past few years than that shown by consumer price indices. This is due to the fact that prices in construction and government consumption (which is determined to a significant extent by government personnel expenditure) have risen much more slowly in Germany relative to the other price components than is the case for the most important competitors.

Indicators of the German economy's price competitiveness

Quarterly, log scale 1



1 Inverted scale: rise of curve (decline in values) denotes increase in price competitiveness. — **2** 1995 Q1 equivalent to the (standardised) indicator value against 20 trading partners (based on deflator of total sales). — **3** Average since 1975 = 100. — **4** 1994 Q1 equivalent to the (standardised) indicator value against 20 trading partners (based on consumer price indices).

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Indicators against a medium-sized group of countries

The most significant innovation, however, is the introduction of an indicator which is calculated against a group of 36 trading partners, ie a medium-sized group of countries. This indicator comprises all of Germany's EU

5 For analytical and econometric purposes, however, it is often useful to employ an indicator going back to the 1970s with the composition of the group of countries being constant. For this reason, the existing indicator defined against a narrow group of 19 countries excluding Slovenia will also continue to be calculated in the future.

Weighting scheme of the recalculated indicators of the German economy's price competitiveness *

In thousandths

Group of countries/country	Price competitiveness of the German economy against a ...						
	... narrow group of countries (19/20 trading partners)			... medium-sized group of countries (36 trading partners)		... broad group of countries (56 trading partners)	
	up to 1998 1	from 1999 2	from 2007 3	up to 1998 1	from 1999 2	up to 1998 1	from 1999 2
Narrow group of countries	1,000.0	1,000.0	1,000.0	858.1	835.2	772.0	756.0
Belgium	70.8	62.6	62.2	60.4	51.9	54.3	47.0
Luxembourg	4.7	4.2	4.2	4.0	3.5	3.6	3.2
Finland	13.9	14.7	14.6	11.9	12.2	10.7	11.0
France	149.6	141.4	140.5	127.5	117.3	114.7	106.2
Greece	6.0	5.8	5.7	5.1	4.8	4.6	4.3
Ireland	12.9	24.3	24.2	11.0	20.2	9.9	18.3
Italy	113.0	103.4	102.7	96.3	85.8	86.6	77.7
Netherlands	83.6	84.5	84.0	71.2	70.2	64.1	63.5
Austria	56.8	55.4	55.1	48.4	46.0	43.6	41.7
Portugal	13.9	13.5	13.4	11.8	11.2	10.6	10.2
Slovenia	.	.	6.2	5.7	5.2	5.1	4.7
Spain	45.9	48.0	47.7	39.1	39.9	35.2	36.1
Denmark	20.0	18.1	18.0	17.1	15.1	15.4	13.6
Sweden	29.4	26.7	26.5	25.0	22.1	22.5	20.0
United Kingdom	107.2	107.3	106.7	91.4	89.1	82.2	80.7
Norway	9.2	7.9	7.9	7.9	6.6	7.1	5.9
Switzerland	54.2	48.5	48.2	46.2	40.2	41.5	36.4
Canada	10.6	12.5	12.4	9.1	10.4	8.2	9.4
USA	119.8	149.8	148.9	102.1	124.3	91.9	112.5
Japan	78.5	71.4	70.9	66.9	59.2	60.2	53.6
Countries added in the medium-sized group of countries	.	.	.	141.9	164.8	127.6	149.2
Bulgaria	.	.	.	1.4	1.5	1.3	1.3
Estonia	.	.	.	0.6	0.8	0.5	0.7
Latvia	.	.	.	0.6	0.8	0.5	0.7
Lithuania	.	.	.	1.1	1.3	1.0	1.1
Malta	.	.	.	0.6	0.6	0.5	0.5
Poland	.	.	.	20.4	24.6	18.4	22.3
Romania	.	.	.	4.3	4.8	3.9	4.4
Slovakia	.	.	.	6.2	7.6	5.6	6.9
Czech Republic	.	.	.	18.9	23.9	17.0	21.7
Hungary	.	.	.	12.3	19.2	11.0	17.4
Cyprus	.	.	.	0.4	0.3	0.3	0.3
China	.	.	.	28.5	37.6	25.6	34.1
Hong Kong SAR	.	.	.	13.5	12.1	12.1	11.0
Republic of Korea	.	.	.	18.0	15.9	16.2	14.4
Singapore	.	.	.	10.5	9.8	9.5	8.8
Australia	.	.	.	4.6	4.0	4.2	3.6
Countries added in the broad group of countries	.	.	.	.	.	100.4	94.8
Iceland	.	.	.	.	.	0.3	0.4
Israel	.	.	.	.	.	4.5	4.9
Croatia	.	.	.	.	.	2.5	1.9
Russia	.	.	.	.	.	12.0	10.1
Turkey	.	.	.	.	.	13.2	12.1
Algeria	.	.	.	.	.	0.4	0.4
Morocco	.	.	.	.	.	1.4	1.3
South Africa	.	.	.	.	.	5.8	5.8
Argentina	.	.	.	.	.	1.9	1.6
Brazil	.	.	.	.	.	8.3	6.9
Chile	.	.	.	.	.	1.3	1.2
Mexico	.	.	.	.	.	4.7	7.7
Venezuela	.	.	.	.	.	0.8	0.6
India	.	.	.	.	.	7.3	6.0
Indonesia	.	.	.	.	.	5.3	3.9
Malaysia	.	.	.	.	.	7.3	6.8
Philippines	.	.	.	.	.	2.6	3.4
Taiwan	.	.	.	.	.	13.5	13.8
Thailand	.	.	.	.	.	6.6	5.4
New Zealand	.	.	.	.	.	0.7	0.6
Total	1,000.0	1,000.0	1,000.0	1,000.0	1,000.0	1,000.0	1,000.0

* A list of the weights used previously may be found in Deutsche Bundesbank, Monthly Report, November 2001, p 51. — **1** Base 1995 to 1997. — **2** Base 1999 to 2001. — **3** At the start of 2007 Slovenia acceded to the euro area and has therefore been added to the narrow group of countries; base 1999 to 2001.

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trading partners as well as Australia, Canada, China, Hong Kong, Japan, Norway, Singapore, Switzerland, South Korea and the United States, and thus – in contrast to the narrow group of countries confined to "traditional" industrial countries – takes due account of the increased importance of Germany's trade links with central and east European countries as well as the countries of East Asia.[6] This development is also reflected, as shown in the table on page 34, in the higher weights given to these economies in the weighting system from 1999 compared with their previous weightings.

Impact of group of countries on indicator movements

A comparison of indicators calculated against a narrow group of 19/20 trading partners and more broadly defined indicators, such as that against 36 trading partners, shows that, notwithstanding their relative co-movement since the mid-1990s, the more broadly defined indicators reveal a stronger increase in the German economy's price competitiveness. Evidently, Germany's price and cost trends against these additionally analysed countries have been – expressed in a common currency – more favourable than in comparison with the industrial countries, which have often recorded inflation trends similar to Germany's.

The discrepancies between the differently defined indicators raise the question of which of these indicators adequately describes developments in price competitiveness. It is not easy to give an unequivocal answer to this question. Since a narrowly defined indicator always suppresses a part of competitive relationships with other countries, a broadly defined indicator is generally preferable. However, the newly created group of 36 trading partners, for instance, differs from the narrow group of countries – as emphasised above – mainly in the inclusion of central and east European transition countries and East Asian emerging economies, which are predominantly characterised by high growth rates of labour productivity. According to the Balassa-Samuelson theorem, the real appreciation of these countries' currencies vis-à-vis Germany – which is responsible for the development of the indicator – is likely to be in part a reflection of a relative increase in the price of internationally non-tradable goods, which does not have a direct impact on Germany's competitive position.[7] Not least owing to such considerations, it would seem prudent to use more than one indicator to be able to derive robust results from a careful analysis of the German economy's price competitiveness.

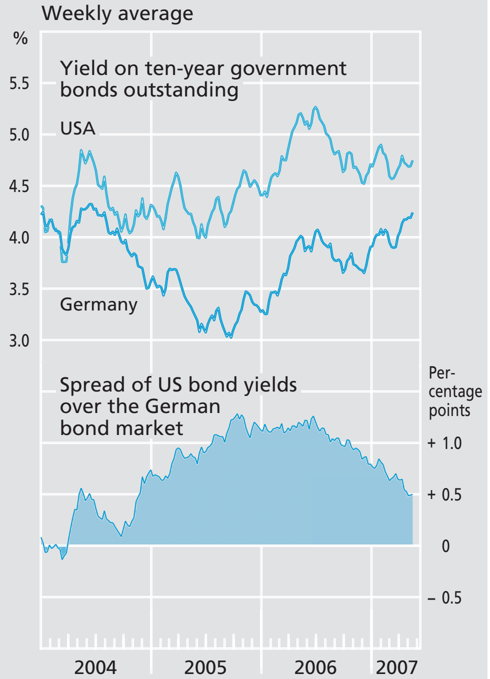
Analysis of more than one indicator prudent for assessment

6 Apart from the fact that an indicator of Germany's price competitiveness – unlike the euro's real effective exchange rate – naturally also has to take account of the trading relationships with the other 12 member states of the euro area, the composition of the new medium-sized group of countries matches that used by the ECB to calculate its EER-24 real effective exchange rate. With regard to the ECB's new EER-44, much the same applies to the new broad group of countries comprising 56 of Germany's trade partners. On the cited effective exchange rates of the euro, see ECB, The effective exchange rates of the euro following the recent euro area and EU enlargements, Monthly Bulletin, March 2007, pp 77-79, and Table 8.1 of Euro Area Statistics in the Monthly Bulletins of the ECB since February 2007.

7 See Deutsche Bundesbank, Fundamental determinants of real exchange rate movements in the central and east European accession countries, Monthly Report, October 2002, pp 47-59.

Bond yields in Germany and the USA

Weekly average



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Securities markets and portfolio transactions

Capital market rates in euro area up ...

In spring, European bond market yields went up to more than 4¼%. This means that government bonds of euro-area issuers were priced around ⅓ percentage point higher overall than at the start of the year. Turbulence in the stock markets at the end of February and the crisis in the US subprime mortgage market in mid-March triggered by the impending insolvency of one major US real estate financier led to increased investment in secure government bonds in Europe, too. The associated decline in yields has since been more than offset by an interest rate hike accompanied by positive economic indicators. The improved economic outlook for the euro area is also reflected by higher real interest rates, which are often used as a simple indicator of the market's assessment of prospective economic growth. At the same time – against the background of an interest rate move by the Governing Council of the ECB in March and further expected interest rate rises – long-term inflation expectations remained unchanged: inflation expectations over the next ten years, measured by the break-even inflation rate,[8] persisted below 2¼%.

... in contrast to lower yields in USA

The performance of the US bond market was entirely different, however, where long-term government bond yields – given the problems in the subprime mortgage market and downward revisions of growth estimates since the beginning of the year – showed virtually no change on balance and, following slight fluctuations, were back at 4¾% at the end of the period under review. Overall, these developments resulted in a marked reduction in the transatlantic yield spread to less than ½ percentage point. As recently as one year previously, the figure had been twice as high.

Upward shift in yield curve

The improved economic outlook – especially for Germany – was also reflected in an upward shift in the yield curve.[9] In early March – the last time the Governing Council of the ECB raised its key interest rates – interest rates in the medium and long-term maturity segments were still more or less at the same level as at the start of the year, but expect-

8 The break-even inflation rate (BEIR) is calculated as the differential between the yields of nominal and inflation-indexed government bonds. The French government bond maturing 2015, which is linked to the euro-area Harmonised Index of Consumer Prices (excluding tobacco), is used for the euro area.
9 This is based on the German yield curve which is recalculated on a daily basis by the Bundesbank.

ations of a further interest rate move and a positive economic setting have since led to an upward trend. At 14 basis points, the interest rate spread between yields on ten-year bonds and one-year bonds remains very small, however. The yield curve is therefore still very flat.

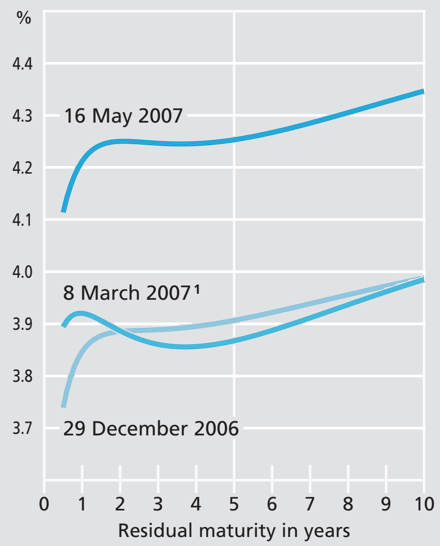
No increase in interest rate spreads on corporate bonds

The higher yields on government bonds has been reflected only in part in increased financing costs for enterprises in the capital market. The yield spread of BBB-rated corporate bonds over euro-area government bonds of comparable maturity narrowed by 15 basis points to less than 1 percentage point in spring. Although the turbulence in the stock markets and the crisis in the US subprime mortgage market meant that there was scarcely any change in the yield spread between investment grade corporate bonds and government bonds, higher spreads were being quoted for a time on non-investment-grade bonds. But these spread widenings, too, were almost completely undone again in the last few weeks, which means that European non-investment-grade corporate bond yields are currently below their level at the beginning of the year. This means that financing conditions for the corporate sector remain favourable on a longer-term comparison.

Buoyant issuing activity in the bond market

With gross sales of domestic debt securities amounting to €324 billion, issuing activity in the German bond market in the first quarter of 2007 was notably more buoyant than in the preceding three months (€256 billion). Even after deducting net redemptions and changes in issuers' holdings of their own securities, German issuers received a substantially greater inflow of funds, at just under

Yield curve
in the German bond market *



* Interest rate for (hypothetical) zero-coupon bonds (Svensson method), based on listed Federal securities. — **1** Before the interest rate increase of 25 basis points by the Governing Council of the ECB.

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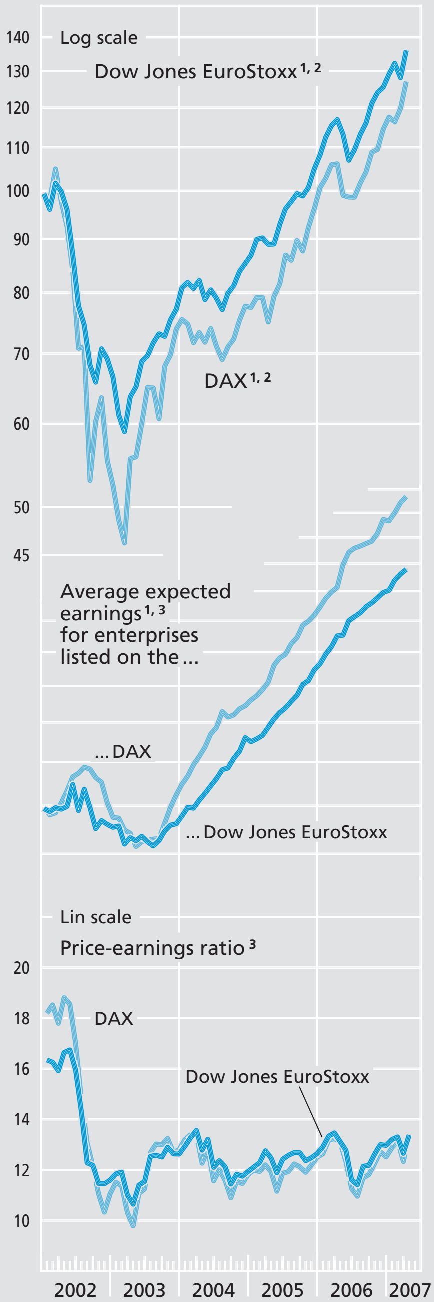
€51 billion net, than in the period from October to December 2006 (€2½ billion). Net sales of foreign debt securities in the German market were on a similar scale (€71 billion) in the reporting period. Around three-quarters of these additional funds were denominated in euro. Foreign bonds and foreign currency-denominated money market paper were sold for €17½ billion in the German market. The total amount of resources raised from sales of domestic and foreign debt securities in the first quarter of 2007 was therefore just under €122 billion, compared with €44½ billion in the preceding quarter.

Higher volume of funds raised by credit institutions ...

Following a weak inflow of funds in the fourth quarter of 2006 (€2½ billion), the German credit institutions, in particular, increased their capital market debt sharply in the re-

Price movements and earnings estimates for European and German public limited companies

Monthly data



1 January 2002 = 100. — **2** Source: Deutsche Börse AG. — **3** Based on year-on-year I/B/E/S analyst estimates ("earnings before goodwill"). Source: Thomson Financial Datastream.

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porting period, at €39 billion. Their issuing activity was focused on the sale of other bank debt securities, which can be structured flexibly, and debt securities of specialised credit institutions with net sales of €27½ billion and €25 billion respectively. By contrast, the domestic banks reduced their debt from mortgage and public Pfandbriefe by €7 billion and €6 billion respectively.

... and the public sector

The public sector tapped the capital market for €5½ billion during the reporting period, which was somewhat more than in the preceding quarter (€4½ billion). The Federal Government's market debt rose by €3 billion. It issued 30-year Bunds worth €6½ billion and ten-year Bunds worth €4 billion. Moreover, in the short-term maturities range, it issued €2½ billion worth of two-year Treasury notes (Schätze) and €½ billion worth of Treasury discount paper (Bubills). At the same time, the Federal Government reduced its borrowing (net debt) in five-year Federal notes (Bobls) by €12 billion since a fairly large volume of earlier issues was due for redemption. State government tapped the capital market for just under €3 billion in the first quarter, which was an amount similar to that in the preceding three months.

Increase in enterprises' market debt

In the first quarter of 2007, German enterprises borrowed €6 billion in the German capital market, having redeemed debt securities on balance in the preceding quarter. They issued short-term instruments to the amount of €8 billion, simultaneously reducing their debt in longer-term debt securities by €2 billion.

Acquisition of debt securities

German debt securities were bought mainly by non-residents in the first quarter of 2007. These investors took solely paper issued by the private sector into their portfolios (€47 billion). By contrast, they sold public sector debt instruments to the amount of €7½ billion. Resident non-banks acquired domestic issues worth €14½ billion. They invested in private and public sector debt instruments on a scale of €8½ billion and €6½ billion respectively. At the same time, non-banks acquired €22 billion worth of foreign bonds. German credit institutions reduced their domestic bond portfolios by €3½ billion net. They sold bank debt securities worth €10½ billion on balance, while purchasing public sector instruments to the amount of €6½ billion. Furthermore, the credit institutions stepped up their investment in foreign bonds and money market paper by €49½ billion.

Ups and downs in the stock markets ...

The general upward movement in the international stock markets continued into the beginning of 2007. It was only when the overheated Chinese stock market slumped at the end of February and problems occurred in the US mortgage market in mid-March – in a setting already shaped by expectations of weak growth for the USA – that, for a time, global stock markets underwent corrections. German and other European equities, in particular, bounced back very quickly, however, and recorded price gains of 12% (CDAX) and 9% (DJ EuroStoxx) overall in comparison with year-end 2006.

... with positive outcome

Since April, the US stock market, too, has been pointing upwards again, however, having gained 6% (S&P 500) since the beginning of the year. This means that the stock markets in the US and Europe have

Investment activity in the German securities markets

€ billion

Item	2006 Q1	2006 Q4	2007 Q1
Debt securities			
Residents	53.3	4.6	82.2
Credit institutions	24.6	21.6	45.7
of which			
Foreign debt securities	29.0	38.4	49.4
Non-banks	28.7	– 16.9	36.5
of which			
Domestic debt securities	16.8	– 20.8	14.7
Non-residents	54.4	40.0	39.8
Shares			
Residents	7.7	– 23.2	– 9.9
Credit institutions	6.1	9.7	5.0
of which			
Domestic shares	7.4	5.1	1.3
Non-banks	1.6	– 32.9	– 14.9
of which			
Domestic shares	– 7.4	– 28.7	4.2
Non-residents	0.6	25.8	– 2.1
Mutual fund shares			
Investment in specialised funds	11.5	7.0	12.3
Investment in funds open to the general public	– 6.3	– 1.9	0.0
of which: Share-based funds	– 0.5	– 1.9	– 2.6

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been approaching their all-time record highs of 2000. Persistently high earnings expectations as well as very buoyant mergers and acquisitions activity are likely to be common factors behind the bullishness of the stock markets. Given the strong cyclical setting, the appreciation of the euro against the US dollar and the yen currently does not appear to be putting a strain on European enterprises, in the eyes of investors. Even market players' initially heightened uncertainty about future price movements (in terms of the VDAX-New and VIX volatility indices for the German and US stock markets respectively), which followed the market turbulence, has now receded somewhat. Overall, market volatility has risen slightly since the start of the year but remains well below its five-year average.

Major items of the balance of payments

€ billion

Item	2006 Q1	2006 Q4	2007 Q1
I Current account 1,2	+ 25.3	+ 42.7	+ 36.8
Foreign trade 1,3	+ 39.2	o + 46.6	+ 48.8
Services 1	– 6.2	– 2.6	– 4.9
Income 1	+ 7.5	+ 7.0	+ 6.8
Current transfers 1	– 10.2	– 3.5	– 10.4
II Capital transfers 1,4	+ 0.2	– 0.1	+ 0.2
III Financial account 1 (Net capital exports: –)	– 39.7	– 37.8	– 74.1
1 Direct investment	– 18.7	+ 9.6	– 5.2
German investment abroad	– 23.0	– 9.5	– 13.4
Foreign investment in Germany	+ 4.3	+ 19.1	+ 8.2
2 Portfolio investment	– 0.5	+ 5.8	– 35.6
German investment abroad	– 60.9	– 52.8	– 72.7
Shares	– 0.4	– 3.3	+ 11.2
Mutual fund shares	– 19.6	– 7.3	– 12.8
Debt securities	– 41.0	– 42.3	– 71.2
Bonds and notes 5	– 41.6	– 44.2	– 65.6
of which Euro-denominated bonds and notes	– 32.8	– 38.7	– 53.8
Money market instruments	+ 0.6	+ 1.9	– 5.6
Foreign investment in Germany	+ 60.4	+ 58.7	+ 37.1
Shares	+ 0.6	+ 17.3	– 3.4
Mutual fund shares	+ 5.3	+ 1.4	+ 0.7
Debt securities	+ 54.4	+ 40.0	+ 39.8
Bonds and notes 5	+ 45.9	+ 48.3	+ 29.8
of which Public bonds and notes	+ 21.5	+ 21.3	– 7.3
Money market instruments	+ 8.5	– 8.3	+ 10.0
3 Financial derivatives 6	– 4.5	– 3.0	– 10.2
4 Other investment 7	– 17.0	– 50.8	– 23.2
Monetary financial institutions 8	– 48.3	– 56.1	– 10.6
of which: short-term	– 30.0	– 23.0	+ 8.9
Enterprises and individuals	– 2.5	– 8.1	– 11.0
of which: short-term	+ 0.1	– 1.7	– 4.1
General government	+ 6.4	+ 3.6	+ 13.6
of which: short-term	+ 5.6	+ 2.9	+ 14.6
Bundesbank	+ 27.4	+ 9.8	– 15.3
5 Change in reserve assets at transaction values (increase: –) 9	+ 1.1	+ 0.6	+ 0.1
IV Errors and omissions	+ 14.3	– 4.8	+ 37.1

1 Balance. — **2** Including supplementary trade items. — **3** Special trade according to the official foreign trade statistics (source: Federal Statistical Office). From January 2007, excluding supplies of goods for/after repair/maintenance which, up to December 2006, were deducted through the supplementary trade items. — **4** Including the acquisition/disposal of non-produced non-financial assets. — **5** Original maturity of more than one year. — **6** Securitised and non-securitised options as well as financial futures contracts. — **7** Includes financial and trade credits, bank deposits and other assets. — **8** Excluding the Bundesbank. — **9** Excluding allocation of SDRs and excluding changes due to value adjustments. — **o** Exports positively influenced by late reports. — Discrepancies due to rounding.

Deutsche Bundesbank

Increased issuing activity in the stock market

Given the generally benign stock market climate, issuing activity in the German stock market was more buoyant in the first quarter of 2007 than in the preceding three months. German enterprises issued just under €3½ billion worth of new shares, compared with just over €2 billion in the fourth quarter of 2006. These were mainly listed equities (€2½ billion). Furthermore, residents sold €15½ billion net worth of foreign shares in the first quarter; it had already been the case that no foreign shares had been sold domestically on balance between October and December.

Share purchases

In the German equity market, domestic non-banks were the strongest group of buyers of German equities in the first quarter of 2007, at €4 billion. At the same time, however, they sold €19 billion worth of foreign bonds. German credit institutions increased their portfolios of domestic and foreign shares by just under €1½ billion and by €3½ billion respectively. By contrast, foreign investors scaled back their investment in the German stock market by €2 billion. They reduced their own equity holdings in the form of portfolio investment by €3½ billion and increased their foreign direct investment (FDI) exposure by €1 billion.[10]

Sales of mutual fund shares

At €12½ billion, domestic mutual investment companies raised substantially more funds in the first quarter of 2007 than in the quarter before (€5 billion). On balance, however, the additional funds were channelled solely into specialised funds reserved for institutional investors. By contrast, the outstanding volume

10 For a detailed breakdown of foreign direct investment, see the adjacent table.

of mutual fund shares open to the general public remained unchanged on balance. Once again, it was mainly equity- and bond-based funds which recorded outflows (€2½ billion and €2 billion respectively). However, open-end real estate funds and money market funds placed more of their own fund shares in the market (€3 billion) than in the preceding quarter (€½ billion). The outstanding shares of the mixed funds increased by just under €1 billion. Once again, sales of shares by foreign funds in Germany showed a marked rise, at €13 billion.

Purchases of mutual fund shares

As in the preceding reporting period, mutual fund shares were bought mainly by German non-banks, which took domestic mutual fund shares worth €9½ billion and shares of foreign investment funds worth €11 billion into their portfolios. By contrast, German credit institutions invested equally in domestic and foreign mutual fund shares (each €2 billion). Non-resident investors bought mutual fund shares to the amount of just over €½ billion.

Foreign direct investment

Net capital exports in foreign direct investment

Besides the aforementioned net capital exports – totalling €35½ billion – due to securities transactions, foreign direct investment (FDI) also saw net outflows of funds amounting to €5 billion in the first quarter of 2007. This followed inflows of funds on a comparable scale in the final quarter of 2006.

The main reason for this was the cross-border investment of German firms, which made €13½ billion worth of capital available to their subsidiaries abroad. This occurred principally through the granting of loans, although profits were also reinvested. As far as it is possible to tell, acquisitions activity was not ultimately reflected in FDI flows during the reporting period since one fairly large-scale acquisition of a firm in Switzerland and the sale of a branch in Austria, in particular, largely offset each other in terms of the amount involved.

In the first three months of 2007, foreign enterprises invested €8 billion in Germany following €19 billion in the fourth quarter of 2006. Building up equity interests and reinvesting profits were the two key activities in this regard.