Financial markets

Financial market trends

Financial market setting

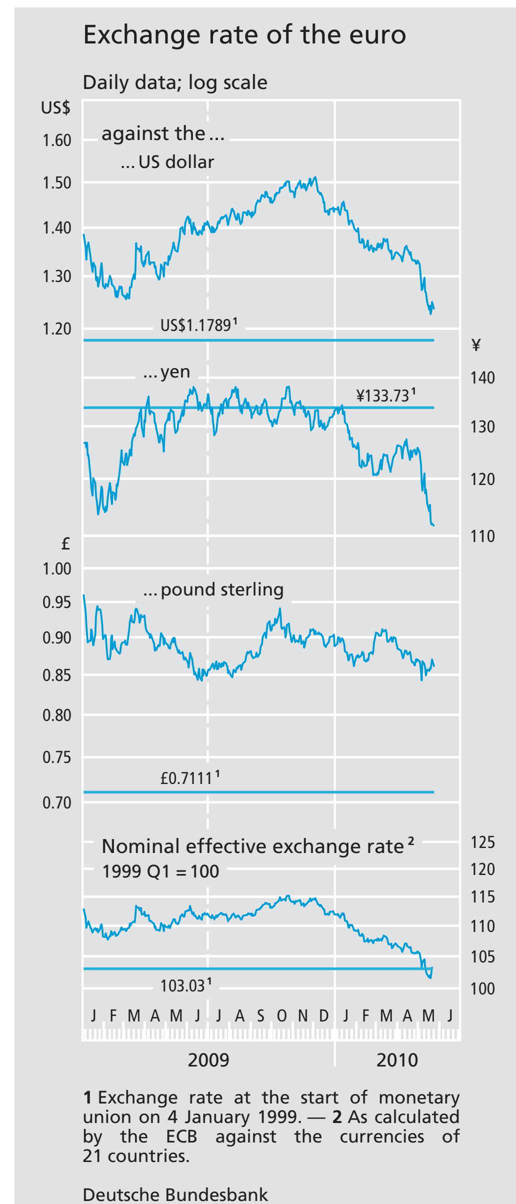
Greece's debt crisis triggered considerable tensions on the financial markets in the second quarter of 2010, particularly when fears of contagion to other euro-area countries arose. Yields on southern European government bonds in particular rose sharply as a result from mid-April onwards, and the gap between euro-area yields widened to unprecedented levels. On the market for credit default swaps, too, the creditworthiness of sovereign issuers was subjected to a fundamental reassessment. In a setting of heightened uncertainty, the euro also came under considerable pressure; moreover, the functioning of various markets was seriously impaired. The crisis risked gaining an uncontrolled momentum that would have jeopardised the stability of the European Monetary Union and depressed the global economy. The large-scale support measures agreed on by the Ecofin Council and the IMF on 9 and 10 May, the announcement of additional consolidation efforts and the decisions by the ECB Governing Council, which include the Eurosystem's purchases of government bonds on the secondary market, finally halted briefly the dramatic slide of prices on southern European bond markets. On the European stock markets, these measures, paired with expectations that the current low-interest-rate environment would persist, caused equity prices to rise. Financial stocks, considered by investors to be especially sensitive to government bond market developments, advanced strongly.

Exchange rates

Euro exchange rate developments against the US dollar, ...

The tensions within the euro area had a knock-on effect on the foreign exchange markets, too, pushing the euro lower. The single currency has depreciated sharply, particularly against the US dollar, since the turn of the year. Besides the dramatic events described above, the gradual economic recovery in the United States has exerted additional pressure on the euro-US dollar exchange rate. At the end of January, for example, it was announced that, in the final quarter of 2009, the US economy had grown more strongly than anticipated, and at a rate that far exceeded the corresponding figure for the euro area, which was published later. Encouraging economic reports and the phasing-out of non-standard monetary policy measures to supply the US financial sector with liquidity fuelled market speculation that US key interest rates might be raised sooner than previously expected. This, too, helped to push the euro lower. When, at the end of February, citing the fragile state of the US labour market, the Fed assured Congress that key rates would remain decidedly low for an extended period, the euro finally stabilised temporarily at US$1.36.

In March, the transatlantic interest rate differential on the capital market, which had previously been close to zero, widened in favour of US government bonds, however. This generated renewed pressure on the euro. Moreover, the market increasingly focused its attention on the ongoing uncertainty surrounding the funding of the Greek budget. This accelerated the decline of the euro in



1 Exchange rate at the start of monetary union on 4 January 1999. — 2 As calculated by the ECB against the currencies of 21 countries.

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May, probably not least because the Greek fiscal crisis was increasingly impacting on the country's banking sector and because contagion effects threatened to spill over into other euro-area countries by way of higher interest rate spreads. The single currency recovered after agreement in principle was reached to provide a support package for Greece, after details of this package were specified two weeks later, and again after the decision was

taken to implement extensive monetary and fiscal policy support measures in the euro area. Yet this had no lasting effect against the background of intensified nervousness on the foreign exchange market. As this report went to press, the euro stood at US$1.24, or 14% down on the beginning of the year.

... against the yen ...

The single currency depreciated against the yen, too, due to the tensions in the euro area, falling from ¥134 to ¥120 between the turn of the year and end-February. At that time, the media were reporting on differences between the Japanese government and the Bank of Japan regarding the need for further monetary policy measures to fight deflation. Boosted by the uncertainties surrounding the adequacy of Japanese economic policy, the euro gained ground again in March. The euro-yen exchange rate stabilised in April after speculation arose regarding the resumption of the renminbi's appreciation against the US dollar and both the Japanese government and the Bank of Japan expressed optimism about the country's economic outlook following upbeat economic reports. In May, growing concern about the fiscal policy soundness of a number of euro-area countries sent the euro lower against the yen, amongst others, while the resultant increase in risk aversion benefited the yen further. As this report went to press the euro stood at ¥112, 16% below its level at the turn of the year.

... and against the pound sterling

Since the beginning of 2010, the euro-sterling exchange rate has presented a mixed picture. The euro lost ground to the pound sterling, particularly in January and from mid-March onwards, but has appreciated noticeably in the meantime. This was due, on the one hand, to disappointment about the rather sluggish pace of economic recovery in the United Kingdom. On the other hand, the UK's precarious budget situation also attracted the markets' attention as a result, amongst other things, of rating agencies' warnings about the credit rating of British government bonds. These fears were fanned further when a sharp drop in UK tax revenue was reported for January. Later, opinion polls indicated that the forthcoming general election might not produce a clear majority; this – it was suspected for a while – would impede resolute consolidation efforts. Against this backdrop, despite its weakness due to Greece's budgetary problems, the euro posted only comparatively minor losses against the pound sterling of 3% on balance since end-2009. It stood at £0.86 as this report went to press.

Effective euro exchange rate

Since the beginning of 2010, the euro's average value vis-à-vis the currencies of 21 major trading partners has fallen by 8½%. Given that the main reasons for these developments are to be found in the euro area itself, exchange rate losses were broad based. Besides the above-mentioned losses vis-à-vis the US dollar and the yen, demand for which is stronger given their market depth and liquidity, the euro sustained particularly heavy losses against the Canadian dollar (of 13½%) and against a number of Far Eastern currencies (eg falling by 10% against the Korean won and by 14% against the Singapore dollar). In these countries, a strong upswing has already set in, which is stimulating capital

inflows, contributing to the appreciation of their respective currencies. In the reporting period, the euro fell to all-time lows against the Australian dollar and the Swiss franc. The price competitiveness of euro-area suppliers compared with important trading partners improved as the euro depreciated, yet from a longer-term perspective it still cannot be considered favourable overall.

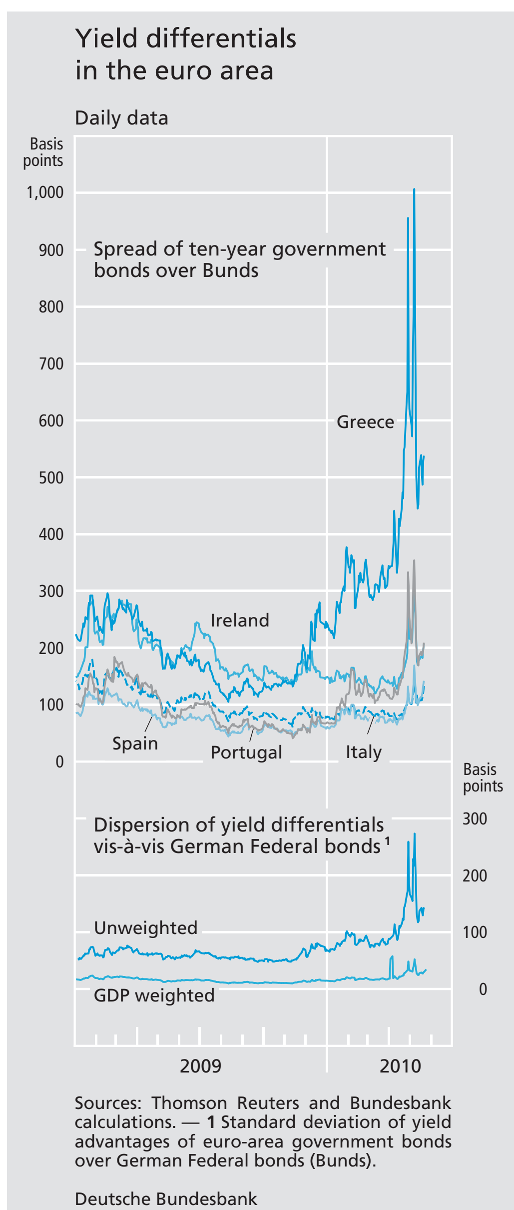
Securities markets and portfolio transactions

Spotlight on spread of the Greek debt crisis

In recent months, developments on the European bond markets have been determined by the Greek debt crisis and its escalation into a crisis of confidence in bonds of other euro-area countries, too. Since the beginning of this year, the GDP-weighted yield differential of the other euro-area government bonds over the corresponding Federal bonds (Bunds) has more than doubled at times; when this report went to press it was, at 107 basis points, still nearly two-thirds above the end-2009 level. The widening was driven primarily by the increase in Greek ten-year government bond yields, which peaked at almost 13% (1,000 basis points over Bunds of comparable maturity). This was largely due to a renewed correction of the Greek budget deficit, strikes in protest against planned consolidation measures and credit downgrades by rating agencies. Greek government bonds last yielded, at just over 8% (premium over Bunds of 540 basis points), markedly less again, although still more than at the beginning of the year. In between, a €110 billion conditional support package was adopted to keep the Hellenic Republic solvent, a euro rescue package was decided on with a planned volume of up to €750 billion and a scheme was launched for the purchase of government bonds by the Eurosystem. The increasing loss of investor confidence resulted in rising government bond yields for Portugal, Ireland and Spain, too, though not to the extent witnessed in Greece. At the same time, yields on government bonds from countries such as Germany and France declined. As this report went to press, ten-year Bunds were yielding 2½%, or just over ¾ percentage point less than at end-2009; they acted as a “safe haven” for the increasingly unsettled investors.

German yield curve steeper

Yields in the short to medium-term segment have fallen even more sharply than at the long end. As a result, the yield curve on the



Sources: Thomson Reuters and Bundesbank calculations. — **1** Standard deviation of yield advantages of euro-area government bonds over German Federal bonds (Bunds).

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German bond market grew even steeper compared with the end of 2009. Based on German Bunds, the spread between ten and two-year yields was, at 237 basis points, very high by historical standards as this report went to press. The renewed steepening of the yield curve mirrors expectations that the Eurosystem will continue to implement its low-interest-rate policy and market players' growing preference for short-dated interest-bearing securities.

International bond markets

Outside of Europe, bond yield volatility has been considerably more moderate since the beginning of the year than in the euro area. After falling until mid-February, the average yield on ten-year US government bonds rose substantially again at the end of February and in March on the back of improved growth prospects, expectations of record issuance of US Treasuries and the passage of the health reform. In early April it even breached the 4% mark for a while before dropping by more than ¾ percentage point as a result of the uncertainty caused by the Greek debt crisis and the investigations by the Securities Exchange Commission (SEC) into a number of large banks. As this report went to press, it stood at 3¼%, which is not only below the level at the end of 2009 but is also lower than the GDP-weighted yield on euro-area government bonds outstanding. In the reporting period, yields on Japanese government bonds slipped slightly on balance and stood at 1¼% at the time of going to press.

Financing conditions for enterprises improved further

In keeping with the brighter economic outlook and the upward movement on the stock markets, the financing conditions for enterprises at first continued to improve on the euro-area credit markets. Since the beginning of the year, yields on BBB-rated, euro-denominated corporate bonds have fallen by roughly ½ percentage point. Yield spreads over sovereign bonds, too, have narrowed slightly by 4 basis points. The more favourable conditions supported the continued strong issuance activity by firms on the capital markets

in the first quarter of 2010. On the credit derivatives markets, however, the assessment of public sector default risk deteriorated. This also affected the evaluation of enterprises; as a result there was no reduction in credit default risk as measured by credit derivative indices (iTraxx).

Net sales in the bond market up

In the first quarter of 2010, debt securities worth €335½ billion gross were issued in the German bond market, so that issuance was again down on the previous quarters. However, net of redemptions, which also decreased, and after taking account of changes in issuers' holdings of their own bonds, securities worth €20 billion were sold, whereas net redemptions were made in the previous quarters. In addition, foreign borrowers sold debt securities for €15 billion on the German market. These were solely euro-denominated paper on balance. With that, funds totalling €35 billion were raised in the German bond market in the reporting period.

Borrowing by German government

In the first quarter of 2010, the public sector tapped the bond market for €32 billion, compared with €6½ billion in the previous quarter. Above all, the German Federal government issued five-year Federal notes (Bobls) worth €16½ billion and ten-year Federal bonds (Bunds) worth €10 billion as well as smaller volumes of two-year Federal Treasury notes (Schätze) for €4½ billion and 30-year Bunds for €3½ billion. By contrast, the German Federal government redeemed Federal Treasury discount paper (Bubills) totalling €10½ billion net. On balance, the state governments issued debt securities worth €7½ billion.

Investment activity in the German securities markets

€ billion

Item	2009 Q1	2009 Q4	2010 Q1
Debt securities			
Residents	23.2	19.7	25.8
Credit institutions	10.1	– 19.1	2.1
of which			
Foreign debt securities	– 25.5	– 9.0	1.5
Non-banks	13.1	38.8	23.7
of which			
Domestic debt securities	– 21.3	9.6	10.4
Non-residents	– 18.7	– 18.6	9.1
Shares			
Residents	13.4	7.6	6.7
Credit institutions	– 5.1	7.1	3.0
of which			
Domestic shares	– 3.6	4.8	3.8
Non-banks	18.5	0.5	3.7
of which			
Domestic shares	12.8	– 1.3	2.4
Non-residents	– 0.9	– 1.1	0.5
Mutual fund shares			
Investment in specialised funds	5.9	19.3	13.9
Investment in funds open to the general public	1.8	3.2	7.0
of which: Share-based funds	0.7	1.6	– 0.4

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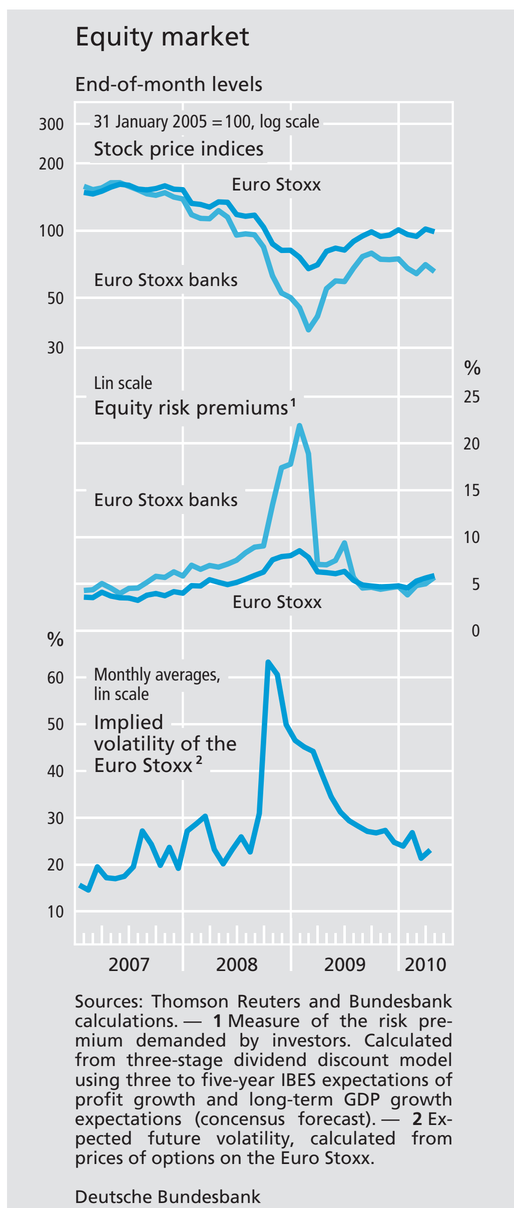
Net redemptions by credit institutions

In the reporting quarter, domestic credit institutions reduced their capital market debt further, namely by €27 billion (fourth quarter of 2009: €28½ billion). In particular, they redeemed other bank debt securities, which can be structured flexibly, (€21 billion net) and public Pfandbriefe (€18½ billion net). Specialised credit institutions, meanwhile, issued debt securities to the tune of €9 billion, and mortgage Pfandbrief sales totalled €3 billion. Of issues placed by credit institutions, a volume of €3 billion was backed by state guarantees.

Issues by non-banks

As financing conditions on the capital market improved further, domestic non-bank corporations issued debt securities amounting to €15 billion net in the reporting quarter. In this issuer group, non-bank financial corporations



Sources: Thomson Reuters and Bundesbank calculations. — 1 Measure of the risk premium demanded by investors. Calculated from three-stage dividend discount model using three to five-year IBES expectations of profit growth and long-term GDP growth expectations (concensus forecast). — 2 Expected future volatility, calculated from prices of options on the Euro Stoxx.

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tapped the capital market for €8½ billion; for the most part, they issued longer-dated paper (€6½ billion).

Purchase of debt securities

In the first quarter of 2010, German non-banks and foreign investors were the main buyers of domestic debt securities, adding paper worth €10½ billion and €9 billion, respectively, to their portfolios. In net terms, domestic credit institutions invested in German interest-bearing paper only on a small scale (€½ billion). In addition, German non-banks and credit institutions invested in foreign debt securities to the tune of €13½ billion and €1½ billion, respectively.

International stock markets hit by Greek debt crisis

At the beginning of the reporting period, Greece's financial problems and talk of a levy on banks set the mood on the international stock markets, driving equity prices on the main stock exchanges down until mid-February. This put pressure on financial stocks in particular, which fell to their lowest levels in several months. All in all, the broad German stock market index CDAX and the European Euro Stoxx index each shed roughly 8% between the beginning of January and early February. Over the same period, Japan's Nikkei index and the US S&P 500 each declined by about 4%. Growing investor uncertainty is also reflected in the implied volatility of equity index options, which rose perceptibly during this time. Positive economic reports triggered a turnaround in stock market sentiment in the following weeks, however. Thus, April business surveys regarding expected GDP growth in the current year on both sides of the Atlantic produced somewhat better results than in March. However, stock prices were probably driven, above all, by longer-term expectations of earnings growth, which have improved since early March. IBES analyst estimates for the Euro Stoxx were raised from 7% to 9½% as this report went to press. In return, the broad Euro Stoxx and the CDAX index posted gains of 12½% and 14%, respectively, between mid-February and mid-April. Since then, however, investors' assessment of stock market developments

has mainly been shaped by the dramatic intensification of the Greek crisis and the massive loss of confidence in the markets for southern European government bonds in particular. Thus, the Euro Stoxx and CDAX indices lost 15% and 11% of their value, respectively, between mid-April and 7 May. Stock price uncertainty as measured by the implied volatility of options on stock price indices has likewise increased sharply since end-April, when Greece requested financial aid. The measures adopted on 9 and 10 May, which include a European financial stability mechanism, sent European stock prices 9% – and, notably, financial stocks 16% – higher. At going to press, the Euro Stoxx and the CDAX were nevertheless roughly 11% and 6% below their respective levels at the beginning of the year.

Higher risk premium

The risk premium demanded by investors for holding stocks – which can be determined using a dividend discount model – has risen since January. At the end of April the implied equity risk premium for the market as a whole was, at almost 6%, at the level recorded before the insolvency of the Lehman Brothers investment bank. By comparison, the figure for bank stocks was, at 5¾%, well below the corresponding level (8¾%). This indicates that investors, taking into account expected earnings developments on the market for bank stocks, are prepared to take considerably more risks than in mid-2008.

Stock market funding and stock purchases

Amidst expectations of a recovery, issuing activity on the domestic stock market picked up again in the first quarter of 2010. Domestic enterprises placed €6½ billion worth of

Major items of the balance of payments

€ billion

Item	2009 Q1	2009 Q4	2010 Q1
I Current account [1,2]	+ 22.6	+ 47.5	+ 31.7
Foreign trade [1,3]	+ 27.5	+ 44.1	+ 37.8
Services [1]	– 1.3	+ 1.8	– 1.5
Income [1]	+ 11.9	+ 11.2	+ 11.2
Current transfers [1]	– 12.9	– 7.4	– 13.4
II Capital transfers [1,4]	+ 0.0	– 0.5	+ 0.3
III Financial account [1] (Net capital exports: –)	+ 4.1	– 81.2	– 9.1
1 Direct investment	– 9.9	+ 8.6	– 25.2
German investment abroad	– 13.6	+ 1.9	– 32.0
Foreign investment in Germany	+ 3.7	+ 6.8	+ 6.8
2 Portfolio investment	– 31.9	– 36.8	– 7.6
German investment abroad	– 9.1	– 18.0	– 19.3
Shares	+ 0.3	– 0.8	+ 3.6
Mutual fund shares	– 0.5	+ 3.0	– 8.0
Debt securities	– 8.9	– 20.2	– 14.8
Bonds and notes [5]	– 14.5	– 21.6	– 18.1
of which Euro-denominated bonds and notes	– 18.6	– 19.9	– 25.9
Money market instruments	+ 5.6	+ 1.4	+ 3.3
Foreign investment in Germany	– 22.8	– 18.8	+ 11.6
Shares	– 4.4	– 0.7	+ 0.8
Mutual fund shares	+ 0.3	+ 0.5	+ 1.8
Debt securities	– 18.7	– 18.6	+ 9.1
Bonds and notes [5]	– 32.5	– 14.2	+ 14.6
of which Public bonds and notes	+ 8.0	+ 2.6	+ 16.4
Money market instruments	+ 13.9	– 4.4	– 5.4
3 Financial derivatives [6]	+ 22.6	– 0.4	– 4.1
4 Other investment [7]	+ 23.1	– 53.2	+ 28.4
Monetary financial institutions [8]	+ 83.7	– 37.7	+ 75.3
of which: short-term	+ 87.3	– 48.9	+ 65.3
Enterprises and households	– 18.9	– 1.8	– 17.8
of which: short-term	– 17.2	+ 5.6	– 9.9
General government	+ 16.7	– 15.4	– 0.2
of which: short-term	+ 17.5	– 15.1	+ 0.9
Bundesbank	– 58.5	+ 1.6	– 28.9
5 Change in reserve assets at transaction values (increase: –) [9]	+ 0.3	+ 0.6	– 0.7
IV Errors and omissions	– 26.7	+ 34.1	– 22.8

1 Balance. — **2** Including supplementary trade items. — **3** Special trade according to the official foreign trade statistics (source: Federal Statistical Office). — **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.

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The European Systemic Risk Board

The financial crisis triggered a series of international-level political initiatives aimed at preventing such crises from recurring.

In October 2008, the European Commission mandated a high-level group of experts chaired by the former French Central Bank Governor and ex-Managing Director of the International Monetary Fund, Jacques de Larosière, to make recommendations on the future regulation and supervision of the European financial markets. In its report of 25 February 2009, the group of experts concluded, among other things, that the regulatory and supervisory bodies had, to date, placed too much emphasis on microprudential supervision, ie monitoring individual institutions, while not enough attention had been paid to the macroprudential risks to the financial system as a whole. The group therefore recommended establishing a Systemic Risk Council charged with analysing the stability of the financial system, developing early warning systems for emerging risks and weaknesses within the financial system and conducting stress tests at the macro level in order to determine the resilience of the financial sector to certain shocks or developments. The group of experts proposed that the council should be placed under the auspices of the European Central Bank (ECB), and that the ECB should, together with the European System of Central Banks (ESCB), be given this responsibility.

The European Council supported this recommendation in June 2009 and asked the European Commission to draw up legislative proposals. The European Commission therefore on 23 September 2009 published proposals for legislation to set up a European Systemic Risk Board (ESRB). The ECOFIN Council reached broad agreement on these proposals on 20 October 2009. The proposals have not yet been discussed by the European Parliament. However, the political objective that the ESRB be operational by 1 January 2011 no longer appears realistic should the European Parliament agree to the large-scale and far-reaching proposals for change put forward by the rapporteurs in its Committee on Economic and Monetary Affairs.

The European Commission has proposed a regulation of the European Parliament and of the Council based on Article 114 of the Treaty on the Functioning of the European Union (TFEU) as the legal basis for the new body without legal personality. Under Article 114 TFEU, the Union may adopt measures for the approximation of provisions laid down by law which have as their object realising the internal market. It is against this backdrop that the ESRB's mandate to contribute to a smooth functioning of the internal market by preventing or mitigating systemic risks should be seen.

The instruments at the ESRB's disposal are, in the main, risk warnings and recommendations for action to address such risks. These may be directed at the EU, the European Commission, the EU member states, national supervisory authorities or the yet to be established European authorities for microprudential supervision, which were also recommended in the de Larosière report and feature in the European Commission proposals. Although the ESRB measures are not legally binding, the ESRB should monitor whether and to what extent the addressees implement the measures within the prescribed time frame. The latter are obliged to present and explain why they choose not, or only partially, to comply with a recommendation.

The ESRB should initially be able to request from the three new European supervisory authorities necessary banking supervision-related information. In any case, existing data should be used where possible to avoid creating an additional burden for the banking industry. The information should generally be presented in such a way as to prevent individual institutions from being identified. Moreover, the ESRB may use statistical data that the ECB collects via the Eurosystem central banks.

The ESRB will cooperate closely with the national supervisory authorities and the new European bodies as well as, at the international level, with the institutions with responsibility for financial stability, for instance the International Monetary Fund and the Financial Stability Board.

The persons acting for the ESRB will be drawn mainly from the EU central banks, most of which already perform financial stability-related tasks at the national level – though the scale of these activities differs.

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Since the start of the monetary union, the Treaty on the Functioning of the European Union (Article 127 (5) TFEU) gives Eurosystem central banks a mandate for financial stability.

The ESRB's decision-making body is the General Board. It will be composed of the President and Vice-President of the ECB and the Governors of the central banks of all EU member states, which are as such also members of the ECB General Council. Further members include a representative of the European Commission and the chairpersons of the new European supervisory authorities as well as one representative per member state of the national supervisory authorities and the President of the EU's Economic and Financial Committee, though these will have no voting rights. The chair of the General Board can only be elected from those members who represent an EU central bank. It is expected that the ECB President will be nominated the Chair of the General Board.

The General Board, in which members not from EU central banks will be in the clear minority, will be supported by a Steering Committee, whose composition does not reflect that of the General Board. Of the 12 members of the Steering Committee, only five besides the Chair and Vice-Chair of the General Board are representatives of EU central banks. Representatives of Eurosystem central banks will probably be in the minority on the Steering Committee.

ESRB members are obliged to act impartially and solely in the interests of the European Union.

The ESRB will be aided by the Advisory Technical Committee comprising technical specialists from the institutions and organs that belong to the General Board. The Banking Supervision Committee (BSC), in which all EU central banks and banking supervisory authorities are represented, has, since 1998, supported the ECB and ESCB by providing analyses of the stability and structure of the EU banking sector. The BSC could therefore form the core of the ESRB's new advisory committee.

The European Parliament is considering reducing the number of central bank representatives in the bodies in favour of academics and people with an industry or trade union background or providers or consumers of financial services. This would go against the proposals put forward in the de Larosière report that the ESRB should be set up under the sole auspices of the central banks due to their expertise.

The secretariat of the ESRB should be ensured by the ECB and provide analytical, statistical, logistical and administrative support to the ESRB. The European Commission has proposed an additional regulation, based on Article 127 (6) TFEU, to establish the secretariat. According to Article 127 (6) TFEU, the Council may, acting unanimously and after consulting the European Parliament and the ECB, confer upon the ECB specific tasks relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.

The Governing Council of the ECB has already stated that the ECB stands ready to ensure the secretariat for the ESRB. Under Article 127 (5) TFEU, the Eurosystem already has a mandate to support the competent authorities for financial stability, which will include the ESRB once it has been set up. This, and an ECB Governing Council decision, could therefore have been used as the legal basis for the provision by the ECB of the secretariat for the ESRB. This would, moreover, have eliminated the need for a unanimous decision by all EU member states, particularly as the relevant regulation of the European Parliament and of the Council can be passed by qualified majority decision in the Council according to Article 114 TFEU.

Particular attention will have to be paid to ensuring that the new dual role played by ESRB members representing EU central banks and, in particular, Eurosystem central banks does not lead to conflicts of interest in the performance of existing tasks within the Eurosystem/ESCB. This is especially true of the Eurosystem's objective of maintaining price stability. It also applies to the Eurosystem's ongoing financial stability-related tasks. This may be of particular relevance as Article 130 TFEU guarantees independence in performing these tasks. The ECB, too, will have to take this into consideration when making organisational arrangements for providing the ESRB's secretariat.

new shares, the vast majority of which were listed equities. The volume of foreign shares outstanding in the German market rose only slightly (€½ billion). Equities were purchased above all by resident non-banks and credit institutions (€3½ billion and €3 billion, respectively), which invested primarily in domestic paper (€2½ billion and €4 billion, respectively). Foreign investors added German stocks worth €½ billion to their portfolios (see Direct investment).

Sales and purchases of mutual fund shares

During the reporting period, domestic investment companies recorded inflows of €21 billion, after raising funds totalling €22½ billion in the previous three months. The fresh funds benefited mainly specialised funds reserved for institutional investors (€14 billion). Of the mutual funds open to the general public, in particular open-end real estate funds and mixed securities-based funds were able to place own shares (€3½ billion and €2½ billion, respectively); mixed funds and fixed income funds sold smaller volumes of certificates (€1 billion and €½ billion, respectively). By contrast, equity funds suffered slight outflows (€½ billion). Foreign funds traded in the German market acquired new resources totalling €8 billion net in the first quarter.

The principal investors in mutual funds were domestic non-banks, adding certificates worth €27 billion to their portfolios – for the most part domestic paper. Foreign investors, meanwhile, invested €2 billion in domestic funds. German credit institutions bought mutual fund shares for €½ billion net; on balance, these were exclusively foreign securities.

Direct investment

German direct investment abroad

As in portfolio investment, which in the first quarter of 2010 recorded net capital exports of €7½ billion, cross-border transactions in direct investment resulted in capital outflows of €25 billion. German parent companies provided their foreign branches with funds amounting to €32 billion, both in the form of equity capital (€14 billion) and via intra-group credit transactions (€12½ billion). Besides the manufacture of transport equipment sector, Germany's banking and insurance industry (€13 billion) were the main direct investors abroad. In this context, an increase by a German credit institution of the capital reserves at a subsidiary played an important role.

Foreign direct investment in Germany

From January to March 2010, foreign firms' investment in their branches in Germany was roughly at the levels recorded in the previous quarter. In net terms, German direct investment enterprises received resources – primarily from the euro area – totalling €7 billion. Whereas equity capital was increased only slightly, reinvested profit shares remained with the German subsidiaries. Moreover, funds were made available in the form of – mostly long-term – intra-group loans. This was true, above all, of the manufacture of transport equipment industry.