Financial markets

Financial market trends

Financial market setting

In the financial markets, market players' attention was increasingly drawn to the heightened tension surrounding public finances in a number of peripheral euro-area countries, as well as to the different economic outlooks in the major currency areas. While many market players were mostly sceptical about the continuing business cycle in the United States and Japan, a number of emerging markets continued to grow strongly, propping up confidence in the financial markets but equally causing pressure on the foreign exchange markets. Germany is currently leading the way in terms of euro-area economic growth, which is having a stabilising effect on the single-currency area as a whole. Yet despite these favourable conditions for Germany, the yield level in the domestic capital market has, on balance, been virtually unchanged since mid-year, albeit with some rather sharp fluctuations and, at one point, an all-time low for Bunds. This was probably mainly attributable to the dampening effects of international interest rate linkage over an extended period, from which Germany, which is so strongly integrated in the international financial markets, could not escape. The positive economic framework data and the partial shift of funds away from safe Bunds into more risky investments only served to atone for this effect. On the international equity markets, favourable quarterly results and improved corporate earnings outlooks for the most part helped prices to rise, and in the foreign exchange markets, the euro continued to trend up vis-à-vis other major currencies against a backdrop of persistent disquietude.

Financial market fears regarding the sustainability of public finances in the peripheral countries of the European currency union have escalated dramatically in recent weeks, the upshot being that Irish and Portuguese government bonds temporarily hit new highs, and yields on Greek bonds also rose significantly again. The principal factors behind these increases were poorer fiscal indicators from debtor countries and an increased level of risk aversion among investors.

Exchange rates

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

Positive economic data, particularly from Germany, have been a mainstay of the euro against the US dollar since the middle of the year, although its influence on exchange rate developments has been masked at times by international investors' shifts in risk appetite. This support initially took the euro to levels of around US$1.32 in August, putting it significantly above the multi-year low of US$1.19 reached in June of this year. Since then, the euro has fallen back due to the increased uncertainty shown by market participants, who appear to be finding safe investments, particularly in the dollar zone, more attractive again. This depreciation also expressed the concerns surrounding the budget situation in several peripheral euro-area countries, as well as European banking sector vulnerability, particularly in Ireland.

In contrast to the euro area's ongoing economic robustness, negative reports on the US economy from mid-September indicated slower US GDP growth and provoked a discussion on the foreign exchange market about further monetary policy easing on the part of the Federal Reserve. A number of trouble-free bond offerings by euro-area countries, launched in some cases with high yield spreads, however, pushed the sovereign debt crisis in Europe out of the spotlight somewhat. As a result, the euro-dollar exchange rate returned to a stable upward trend, which compensated for a large share of the price losses accumulated during the first half of 2010. At the beginning of November, the Federal Reserve decided, as expected, to purchase US Treasuries worth US$600 billion, further depressing the US dollar across the world. At the time of going to print, the euro-dollar rate was US$1.36, around 5½% down on the start of the year.

... against the yen ...

Unlike the euro's appreciation against the US dollar, the euro-yen rate during the reporting period stayed mainly within a narrow band of 110 to 115 yen. The only exception came in early August, when the euro temporarily depreciated against the yen as international investors – their perception of risk rising – may have reduced the scale of carry trades and unwound short positions in yen. During the course of this development, the yen appreciated considerably across the board and reached multi-year highs against the euro and the US dollar. On 15 September 2010, there was a massive intervention in the foreign exchange market by the Bank of Japan – its first for more than six years –

much to the detriment of the yen. This prompted a complete recovery of the euro-yen rate's losses outlined above and rapid appreciation by 4%. As this report went to press, the rate stood at 113 yen, which is still around 15% down on the start of the year.

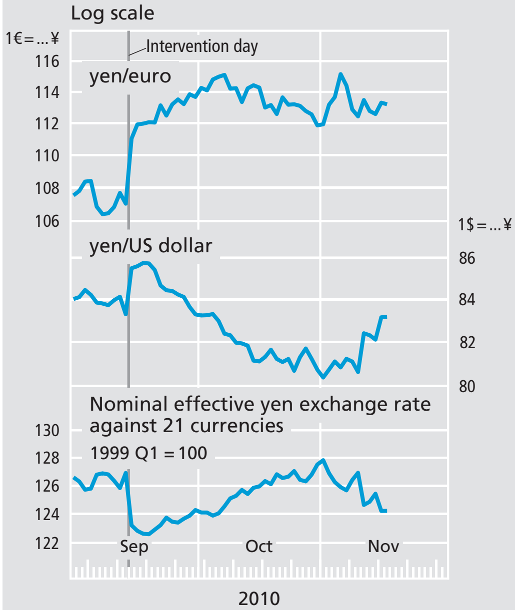
... and against the pound sterling

Following minor fluctuations in August around the 0.82 pound sterling mark, the euro-pound rate experienced marked appreciation over the following two months. The driving force behind this was seen to be the challenging budget situation in the United Kingdom. Market participants feared that the consolidation measures announced by the British government would harm the country's economic recovery on a sustained basis. These worries pushed up the euro and virtually eliminated the losses it accrued during the first half of the year. A surprisingly sharp increase in third quarter UK growth calmed investors' fears, however, and the euro fell back to around 0.85 pound sterling.

Effective euro exchange rates

The euro fared weakly against the Swiss franc at the start of the reporting period, reaching an all-time low in early September. The euro-franc rate recovered from these losses thereafter, however, and of late was trading again at around 1.34 Swiss francs. These changes were reflected in the euro's average value vis-à-vis the 21 major currencies, with the exchange rate index rising roughly 1½% since the end of June. At last count, the euro's effective exchange rate was 6½% below its level at the beginning of the year and roughly 1½% higher than at the launch of monetary union. In real terms, too, ie taking account of the simultaneous inflation differentials between the euro area and its major trading partners, the euro has risen of late, which indicates a decline in price competitiveness.

Yen exchange rates during the course of the Bank of Japan's foreign exchange market operations



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In view of the moderate price and cost developments in Germany over the past years, however, the price competitiveness of the German economy should continue to be rated favourably. As the box on pages 42-43 show, the growing significance of German trade links with central and east European countries over the past years has helped broad indicators show a noticeable increase in the German economy's price competitiveness.

Securities markets and portfolio transactions

International bond markets

While participants in the European bond markets continued to focus their attention mainly on the fiscal position of EMU member states in the summer and autumn months, factors that served to drive down interest rates predominated in the major non-European industrial countries for long periods. In the United States, for example, a number of weaker-than-expected economic figures indicated a slowdown in the economy. Concurrently, there were at times increasing signs of the recovery losing momentum in Japan. The result was a temporary fall in ten-year US Treasury yields to under 2½%, while in Japan, investors were for a time demanding no more than 0.85% per year for investing in ten-year bonds. The central banks of both countries decided to reinitiate their quantative easing policies in the autumn months; nevertheless, a moderate countermovement began in the bond markets at the beginning of November which was fuelled by rising inflation expectations, particularly in the United States, and better economic indicators of late. Ultimately, ten-year government bond yields for the United States and Japan were, at just under 3% and slightly above 1% respectively in mid-November, at roughly their mid-June levels.

Yield movements in the euro area

Although international influences contributed to yield developments in the euro area, they did not define them. For instance, the GDP-weighted yield on ten-year euro-area government bonds was slightly above its June level of late at just over 3¾%. This average figure disguises the massive shifts in yield levels in the individual EMU countries. In keeping with fundamentals and their assessments of risk, investors continued to make very strong differentiations between issuers. While Bund yields temporarily fell near to a record low of close to 2% – though besides safe-haven effects, the international interest rate trend may have contributed to this – bond prices in some euro-area partner countries came under heavy pressure. Irish sovereign debt lost a great deal of value when it became evident that bank support was costing the government more than feared and rating agencies downgraded Ireland's sovereign rating. Investors were also concerned about the fiscal situation in Portugal, where bond yields were at their highest level since the launch of monetary union. The prices of Greek government debt spiked in September, but subsequently eased perceptibly when the budget deficit for 2009 had to be revised upwards again and it was announced that tax revenues could fall short of the restructuring conditions in the financial support package. Recently, the prices of government bonds in peripheral countries were probably bolstered by a joint declaration by the larger EU countries to involve private creditors in a future sustainable crisis resolution mechanism.

The period since the end of August has also seen an overall rise in euro-area bond yields, thanks in no small part to the surprisingly sharp increase in growth – fuelled predominantly by Germany – which met with a very positive response from the financial markets. Against this backdrop, some investors reacted by accepting somewhat more risk and moving funds from safe and liquid investments, which in this case were predominantly German Bunds, into equities. At any rate, German Bund yields initially rose by almost 20 basis points, more than the average of the other euro-area sovereign bonds with the same maturity. By the end of the reporting period, amidst worries concerning the debt crisis, bond yields widened again, however, and led to ten-year Bunds being traded at slightly above 2½% and therefore 40 basis points higher than at the end of August. This means that the current yield level more or less matches that seen in the middle of the year.

Flattened yield curve

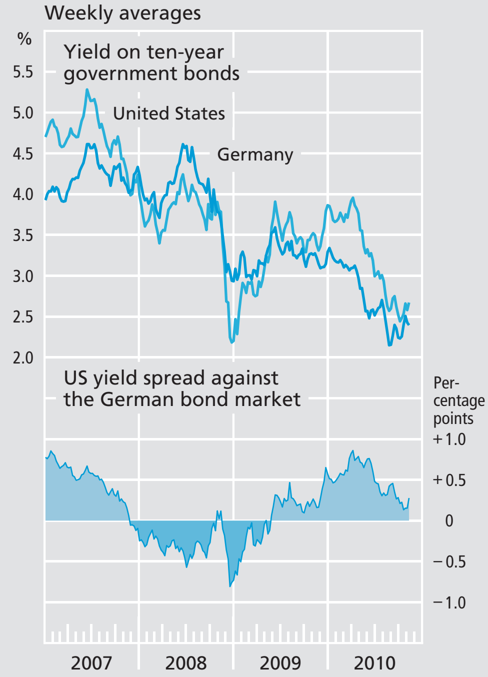
The yield curve, which is calculated based on interest rates for Federal debt securities, has flattened quite markedly since the middle of the year. The difference between ten-year and two-year yields has narrowed by 55 basis points to 175 basis points, which is still considerably above the five-year average of just over 110 basis points. An element of this development may be attributed to the fact that market participants expect a quicker normalisation of interest rate conditions on the money market than they did at the end of June.

Financing conditions for enterprises

Funding conditions for European enterprises on the bond markets improved perceptibly over the reporting period. First, market participants had a more optimistic assessment of credit risk in light of the positive economic indicators, and second, a decline in the liquidity premium demanded by investors may have helped improve financing conditions. The calming on the credit markets is in keeping with the fall in price uncertainty observed on the stock markets. As this article went to press, the spreads on BBB-rated corporate bonds denominated in euro against Federal government bonds – as measured by the iBoxx bond indices – were, at 270 basis points, 50 basis points lower than at the end of June. Yields on BBB-rated corporate bonds fell by just under one half of a percentage point. The situation on the markets for corporate credit default swaps (CDS) was also easing. As measured by the credit derivatives index iTraxx Europe, which is composed of credit default swaps referencing investment grade credits, CDS premiums were, at the end of the reporting period, 25 basis points lower than at the end of June at just under 105 basis points.

Bond yields in Germany and the United States

Weekly averages



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Recalculated weights for 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. These indicators comply with the concept of real effective exchange rates, as calculated by the European Central Bank for the euro, for example. The individual trading partners are included in the indicators with trade weights, which are adjusted to the changing trade flows over time. The regular adjustments aim to take account of the current developments in foreign trade. The same applies to the latest recalculation. Previously the trade weights for all ranges of indicators up to 1998 were based on data from the years 1995 to 1997, and from 1999 onwards on data from the years 1999 to 2001.[1] For all ranges of indicators up to 1997 the new weights are based on data from the years 1995 to 1997, from 1998 to 2000 and from 2001 to 2003 on the trade data of the corresponding period, and from 2004 onwards on data from the years 2004 to 2006 (see table on page 43).

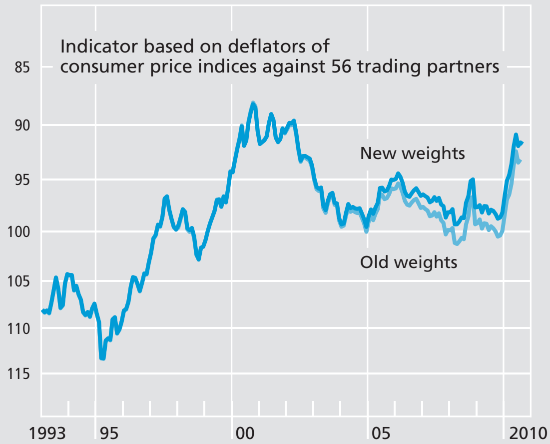
The Bundesbank calculates and publishes the indicators of the German economy's price competitiveness against three groups of trading partners: first the narrow group of 19 or 23 countries, which is regularly extended by new euro-area countries and which in addition to the euro-area countries includes eight industrial nations; second the medium-sized group (36 countries) which includes an additional 13 countries – including China and eight central and eastern European EU countries – and third the broad group (56 countries), which comprises 20 further important trading partners. The table on page 43 displays the recalculated trade weights for the medium-sized and broad group of countries. The weights for the narrow (and the medium-sized) group of countries can be determined by simply rescaling the weights calculated for the broad group.[3]

Over the past decade, the significance of China and the central and eastern European countries for Germany's foreign trade has steadily increased, whilst the share of advanced economies such as the United States, Japan, the United Kingdom and France has gradually fallen. In contrast to the indicator based on the narrow group of countries, the broader indicators take account of the growing significance of the German trading connections to central and eastern European as well as east Asian countries. As shown in the table on page 43, this development is also reflected in the higher weights which these economies have received over time.

As a result of the recalculation of the weights, the indicators for the broader group of countries show a somewhat stronger improvement in the price competitiveness of the German economy in recent years than previously (see adjacent chart). The recalculated indicator of price competitiveness against 56 countries (36 countries) for the period December 1998 to August 2010 shows an improvement of 10% (8%), whilst if applying the old weights there would have been a slightly lower rise of 8% (7%). This effect is due to the fact that price developments in the now more heavily weighted countries have proceeded more unfavourably on the whole than the average for the partner countries. However, the updating of the weights does not have any significant influence on the progression of the narrow indicator.

Price competitiveness of the German economy

1999 Q1 = 100, monthly, log scale[2]



1 A list of the weights used so far can be found in Deutsche Bundesbank, Monthly Report, May 2008, p 40. — 2 Inverted scale: rising curve (decline in values) denotes an increase in competitiveness. — 3 The method used in calculating the weights for the broad group of countries is described in: L Buldorini, S Makrydakis and C Thimann (2001), The effective exchange rates of the euro, ECB Occasional Paper No 2.

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Weighting scheme for indicators of price competitiveness

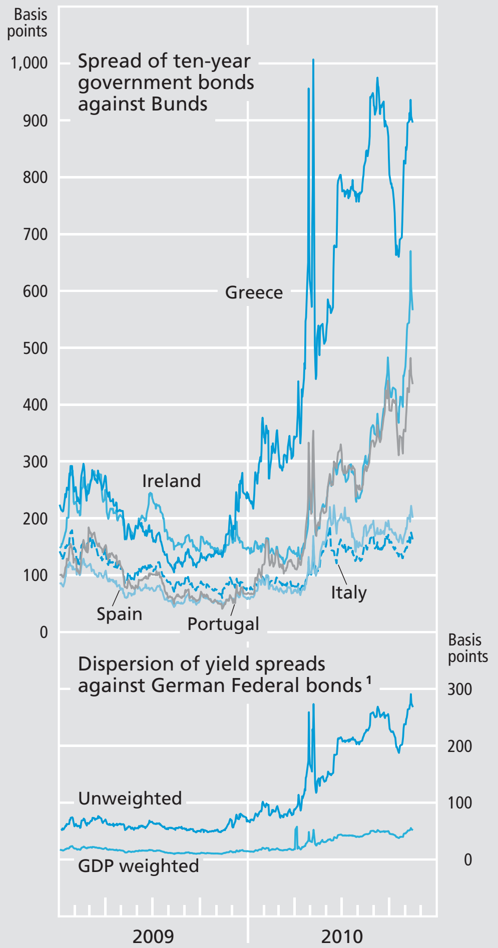
In thousandths

Group of countries/country	Price competitiveness of the German economy against a ...							
	... medium-sized group of countries (36 trading partners)				... broad group of countries (56 trading partners)			
	Up to 1997[4]	1998-2000	2001-2003	From 2004[5]	Up to 1997[4]	1998-2000	2001-2003	From 2004[5]
Narrow group of countries	865.3	855.8	821.1	786.5	778.5	773.7	742.5	707.6
Belgium	60.4	53.6	57.7	62.7	54.3	48.4	52.2	56.5
Finland	11.9	12.4	12.2	12.1	10.7	11.2	11.0	10.9
France	127.5	116.2	107.8	100.7	114.7	105.0	97.4	90.6
Greece	5.1	5.0	4.8	4.9	4.6	4.5	4.3	4.4
Ireland	11.0	17.9	17.8	14.0	9.9	16.2	16.1	12.6
Italy	96.3	89.8	84.2	81.5	86.6	81.1	76.2	73.3
Luxembourg	4.0	3.5	4.1	4.6	3.6	3.2	3.7	4.1
Malta	0.6	0.5	0.5	0.4	0.5	0.5	0.5	0.4
Netherlands	71.2	71.9	70.1	74.9	64.1	65.0	63.4	67.4
Austria	48.4	47.7	45.5	46.6	43.6	43.1	41.2	41.9
Portugal	11.8	11.7	10.7	8.7	10.6	10.6	9.7	7.8
Slovenia	5.7	4.9	5.0	5.1	5.1	4.4	4.5	4.6
Spain	39.1	41.5	42.3	44.1	35.2	37.5	38.3	39.7
Cyprus	0.4	0.3	0.4	0.5	0.3	0.3	0.3	0.5
Denmark	17.1	15.4	15.8	14.9	15.4	13.9	14.2	13.4
Sweden	25.0	23.3	21.1	22.6	22.5	21.1	19.1	20.4
United Kingdom	91.4	90.9	85.8	78.9	82.2	82.2	77.6	71.0
Norway	7.9	6.8	6.5	6.0	7.1	6.2	5.8	5.4
Switzerland	46.2	42.2	41.3	39.0	41.6	38.1	37.3	35.1
Slovakia	6.2	7.0	10.0	11.5	5.6	6.4	9.1	10.3
Japan	66.9	60.9	49.9	44.1	60.2	55.1	45.1	39.6
Canada	9.1	9.7	9.9	8.4	8.2	8.8	9.0	7.5
United States of America	102.1	122.7	117.7	100.3	91.9	110.9	106.5	90.2
Countries additionally included in medium-sized group	134.7	144.2	178.9	213.5	121.2	130.1	161.8	192.0
Bulgaria	1.4	1.3	1.8	2.4	1.3	1.2	1.6	2.2
Estonia	0.6	0.7	1.0	1.1	0.5	0.6	0.9	1.0
Latvia	0.6	0.7	1.0	0.9	0.5	0.6	0.9	0.8
Lithuania	1.1	1.2	1.7	1.8	1.0	1.0	1.5	1.6
Poland	20.4	23.2	27.7	30.1	18.4	21.0	25.1	27.0
Romania	4.3	4.6	5.9	7.9	3.9	4.2	5.4	7.1
Czech Republic	18.9	21.0	28.8	28.6	17.0	18.9	26.0	25.8
Hungary	12.3	16.6	21.0	21.6	11.0	15.0	19.0	19.4
China	28.5	34.8	49.7	72.6	25.6	31.4	44.9	65.3
Hong Kong SAR	13.5	11.2	11.1	11.5	12.1	10.1	10.1	10.3
Republic of Korea	18.0	15.3	15.9	21.1	16.2	13.8	14.4	19.0
Singapore	10.5	9.4	9.1	9.6	9.5	8.5	8.2	8.6
Australia	4.6	4.2	4.2	4.3	4.2	3.8	3.8	3.9
Countries additionally included in broad group	.	.	.	.	100.3	96.2	95.7	100.4
Iceland	.	.	.	.	0.3	0.5	0.5	0.6
Israel	.	.	.	.	4.5	4.5	4.1	3.2
Croatia	.	.	.	.	2.5	2.1	2.1	2.2
Russia	.	.	.		12.0	10.4	12.2	16.0
Turkey	.	.	.	.	13.2	13.6	13.4	15.3
Algeria	.	.	.	.	0.4	0.3	0.4	0.5
Morocco	.	.	.	.	1.4	1.4	1.4	1.3
South Africa	.	.	.	.	5.8	5.3	6.1	6.5
Argentina	.	.	.	.	1.9	1.8	1.2	1.2
Brazil	.	.	.	.	8.3	7.3	6.3	7.0
Chile	.	.	.	.	1.3	1.2	1.2	1.9
Mexico	.	.	.	.	4.7	7.3	7.8	7.6
Venezuela	.	.	.	.	0.7	0.6	0.7	0.6
India	.	.	.	.	7.3	6.1	6.7	8.4
Indonesia	.	.	.	.	5.3	4.2	4.0	3.4
Malaysia	.	.	.	.	7.3	6.7	6.6	6.2
Philippines	.	.	.	.	2.6	3.2	3.5	2.9
Taiwan	.	.	.	.	13.5	13.8	11.4	9.7
Thailand	.	.	.	.	6.6	5.3	5.4	5.2
New Zealand	.	.	.	.	0.7	0.6	0.7	0.7
Total	1,000.0	1,000.0	1,000.0	1,000.0	1,000.0	1,000.0	1,000.0	1,000.0

The rescaling is achieved by adding the weights of the countries which do not belong to this group of countries under review proportionately to the weights of the remaining countries. Therefore the weight of a country in the broad group of countries is set in relation to the total weight of the group of countries under review in the broad group. — **4** Basis 1995 to 1997. — **5** Basis 2004 to 2006.

Yield spreads in the euro area

Daily data



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

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Net redemptions in the bond market

The positive economic environment is also reflected in lower external financing needs on the part of market participants. Issuing activity in the German bond market was relatively subdued in the third quarter. In total, domestic debt securities amounting to just €324½ billion were issued, which represents the lowest issue volume for three years. Taking the redemptions and changes in issuers' holdings into account, domestic issuers reduced their capital market borrowing by €23½ billion. By contrast, foreign issuers placed debt securities worth €18 billion, consisting primarily of euro-denominated securities (€13½ billion), on the German market. On balance, €5 billion was redeemed on the domestic bond market.

Public sector borrowing low

The public sector raised its bond market debt by €14½ billion in the third quarter. Thus, it tapped the capital market to a much lower degree than in the first two quarters of the year (quarterly average: €27 billion). The Federal government accounted for €11 billion of this borrowing, a somewhat smaller amount than was initially planned for in its issuance preview of December 2009. This reflects the cyclically driven improvement in the development of the public sector budgetary situation. The debt instruments of choice were five-year Federal notes (Bobls), which the Federal government sold for €10½ billion. In addition, it issued two-year Federal Treasury notes (Schätze) worth €2½ billion, 30-year Federal bonds (€3 billion) and, to a small extent, Federal Treasury discount paper (Bubils) worth €½ billion. On the other hand, it redeemed ten-year bonds (€4½ billion) and recorded outflows in Federal Treasury financing paper and day bonds used by private investors. The Federal states expanded their capital market debt by €3½ billion.

Net redemptions by non-banks and ...

Domestic enterprises reduced their capital market borrowing slightly by a total of €1½ billion during the reporting period. They issued debt securities (€1 billion net), but redeemed short-term commercial paper worth €2 billion. The decline in tapping the capital market indicates a comparatively good corporate liquidity position.

... credit institutions

Credit institutions reduced their bond market debt by €36½ billion net, continuing the trend that has prevailed since the outbreak of the financial crisis. They mainly redeemed other bank debt securities that allow flexible structuring (€18 billion), an instrument that on balance has barely been used since mid-2007, as well as public Pfandbriefe (€22 billion). The mortgage Pfandbrief business only picked up again towards the end of the quarter. Calculated for the quarter however, paper such as this continued to be withdrawn (€2 billion).[1] By contrast, specialised credit institutions, which include the public promotional banks, issued bonds worth €5 billion (net).

Investment activity in the German securities markets

€ billion

Item	2009 Q3	2010 Q2	2010 Q3
Debt securities			
Residents	11.2	– 10.0	– 43.7
Credit institutions	– 5.4	– 44.4	– 31.9
of which			
Foreign debt securities	– 9.9	– 40.3	– 10.9
Non-banks	16.7	34.3	– 11.7
of which			
Domestic debt securities	– 10.4	– 2.7	– 40.8
Non-residents	– 16.5	3.9	38.5
Shares			
Residents	– 7.4	12.4	– 2.7
Credit institutions	– 8.0	– 1.4	– 3.1
of which			
Domestic shares	– 7.6	– 4.4	– 1.4
Non-banks	0.6	13.8	0.4
of which			
Domestic shares	– 0.7	6.5	0.6
Non-residents	13.0	– 1.3	2.0
Mutual fund shares			
Investment in specialised funds	12.3	14.0	20.2
Investment in funds open to the general public	0.9	0.6	3.0
of which: Share-based funds	1.3	– 1.3	0.3

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Purchase of debt securities

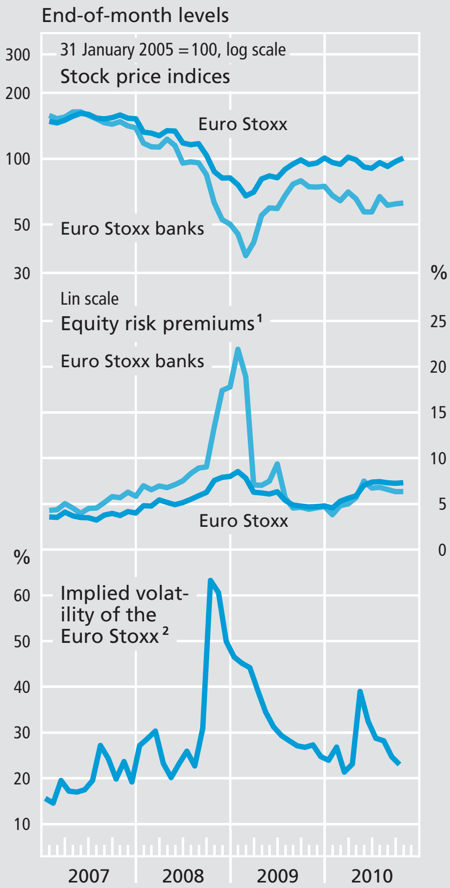
Domestic investors disposed of large volumes of debt securities across sectors (€43½ billion). Domestic paper bore the sole brunt of this withdrawal on balance, with credit institutions and non-banks selling a combined total of €72½ billion worth of these securities from their portfolios – an unusually high volume. While financial institutions shifted some funds from bank debt securities into Federal government securities, on the whole, non-banks withdrew from the German bond market in the reporting period. Differences between the sectors also became apparent in foreign issuers' exposure to debt securities. While the financial sector used the market to dispose of its debt securities, non-banks used it to increase their holdings. By contrast, foreign investors were very active in the third quarter, investing €38½ billion in the German market, primarily in Federal government paper.

After sideways movement, international equity markets ...

The international equity markets initially swung between hope and fear in the summer months. The positive stemmed from the EU's economic recovery, especially the strong economic growth in Germany in the second quarter, and from emerging markets, while uncertainty arose mainly from concerns surrounding the further development of the US economy. Furthermore, a certain amount of pressure was exerted on stock prices because some market participants, given the tense public finance situation of the euro-area peripheral countries, feared the temporary negative impacts the urgently required

1 The Eurosystem's covered bonds purchase programme expired at the end of June 2010.

Equity market



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. Monthly averages.

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consolidation measures may bring. Against this background, equity prices on both sides of the Atlantic moved mainly sideways, with relatively high fluctuations, until the end of August.

... see strong price gains

Buoyed by friendly economic signals that were reflected in positive quarterly results and improved corporate profit expectations in the euro area and the United States, the period since September has been characterised by significant rises in stock market prices. Moreover, investors' expectations of further quantative easing in the United States were reinforced, and were actually fulfilled in November, additionally driving up prices. This wave of increasing confidence may have led investors to withdraw funds they had placed in safe havens and invest more heavily in the stock markets. Unlike with bonds, uncertainty regarding the price trend reduced for equities during the remainder of the reporting period. For instance, one measure of fluctuation (the implicit volatility of options) for future share price developments fell further and was below its five-year average worldwide as this report went to press. German and European equities, measured against the broad-based CDAX and Euro Stoxx indices, therefore recorded price gains of 13% and 11% respectively, while US shares (S&P 500) were up 16%.

Equity risk premiums

The excess return investors demand for an investment in European shares (Euro Stoxx) as compared to a secure investment, which can be calculated using a dividend discount model, remained virtually unchanged at around 7¼%, and is therefore still clearly above the five-year average (around 5¼%). This indicates that risk aversion among investors active in the overall market is still at a comparatively high level despite the considerable gains. The implied risk premium of an exposure to European banking stocks rose to just under 6¼% at the end of the period under review, which is somewhat below its five-year average.

Stock market funding and stock purchases

Issuing activity in the domestic stock market remained subdued in the third quarter, notwithstanding the positive economic prospects. Domestic enterprises issued €1 billion in new shares, compared with €½ billion in the months April to June. By contrast, the outstanding amount of foreign equities in the German market decreased by €2 billion. Equities were mainly purchased by foreign investors (€2 billion), which were almost entirely portfolio investments. Resident non-banks purchased shares for €½ billion, and only invested in domestic shares. Credit institutions, for their part, reduced their domestic and foreign equity holdings evenly (-€1½ billion in each case).

Sales and purchases of mutual fund shares

In the reporting period, domestic mutual funds recorded a net inflow of €23 billion compared with €14½ billion in the previous quarter. The fresh money benefited mainly specialised funds reserved for institutional investors (€20 billion). Among funds open to the general public, mixed securities-based funds (€1½ billion), mixed funds, bond-based funds, share-based funds and open-end real estate funds (€½ billion each) attracted inflows. Sales of foreign mutual fund units in Germany totalled €5½ billion.

Mutual fund shares were bought almost exclusively by domestic non-banks, which placed €29½ billion worth of such shares in their portfolios, the majority being domestic fund shares (€24½ billion). Credit institutions reduced their exposure to mutual fund shares by €½ billion, but on balance only sold domestic fund shares (-€1 billion). Non-resident

Major items of the balance of payments

€ billion

Item	2009 Q3	2010 Q2	2010 Q3
I Current account 1, 2	+ 28.6	+ 25.9	+ 28.1
Foreign trade 1, 3	r + 36,1	+ 37.1	+ 39.3
Services 1	– 7.8	– 2.9	– 7.3
Income 1	+ 10.7	+ 0.9	+ 10.0
Current transfers 1	– 8.2	– 6.4	– 10.6
II Capital transfers 1, 4	– 0.0	– 0.4	+ 0.1
III Financial account 1 (Net capital exports: –)	– 14.5	– 20.9	– 16.0
1 Direct investment	– 10.5	– 26.4	+ 11.3
German investment abroad	– 17.2	– 31.5	+ 3.5
Foreign investment in Germany	+ 6.8	+ 5.1	+ 7.7
2 Portfolio investment	– 23.7	– 0.4	+ 18.6
German investment abroad	– 18.4	– 3.6	– 21.3
Shares	– 0.3	– 3.7	+ 2.4
Mutual fund shares	– 0.9	– 3.2	– 5.5
Debt securities	– 17.3	+ 3.3	– 18.2
Bonds and notes 5	– 19.9	– 0.1	– 16.9
of which Euro-denominated bonds and notes	– 20.6	+ 0.5	– 11.7
Money market instruments	+ 2.7	+ 3.4	– 1.4
Foreign investment in Germany	– 5.3	+ 3.2	+ 39.9
Shares	+ 11.8	– 1.5	+ 1.9
Mutual fund shares	– 0.6	+ 0.7	– 0.5
Debt securities	– 16.5	+ 3.9	+ 38.5
Bonds and notes 5	– 27.4	+ 19.8	+ 25.3
of which Public bonds and notes	– 8.3	+ 22.9	+ 25.1
Money market instruments	+ 10.9	– 15.9	+ 13.1
3 Financial derivatives 6	– 5.9	– 6.3	– 6.6
4 Other investment 7	+ 23.2	+ 13.1	– 39.5
Monetary financial institutions 8	+ 25.3	+ 49.9	+ 42.4
of which: short-term	+ 11.7	+ 41.0	+ 15.5
Enterprises and households	– 7.5	– 4.1	– 14.0
of which: short-term	+ 4.9	+ 5.2	– 1.5
General government	+ 14.9	+ 7.6	– 7.2
of which: short-term	+ 15.1	+ 7.3	+ 3.2
Bundesbank	– 9.4	– 40.2	– 60.7
5 Change in reserve assets at transaction values (increase: –) 9	+ 2.3	– 0.8	+ 0.3
IV Errors and omissions	– 14.0	– 4.6	– 12.2

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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investors reduced their holdings of domestic fund units by €½ billion.

Direct investment

German direct investment abroad

Like portfolio investment (€18½ billion), direct investment also recorded net capital inflows in the third quarter of 2010 (€11½ billion). By contrast, the second quarter of the year saw net capital outflows of €26½ billion. This turnaround was principally attributable to the downturn in cross-border investment by German enterprises, which removed €3½ billion from their foreign subsidiaries on balance exclusively in the form of intra-group credit transactions (€16 billion). In the preceding quarter, domestic enterprises had increased their direct investment abroad by €31½ billion. The main participants in this deduction of capital were domestic holding companies and enterprises from the telecommunications sector. The countries most strongly affected were the Netherlands and the United Kingdom.

Foreign direct investment in Germany

Direct investment by foreign enterprises in Germany amounted to €7½ billion for the July to September period, after €5 billion in the previous quarter. Non-resident proprietors, primarily from the European Economic Area, supplied their German-based subsidiaries with new equity capital (€3½ billion) and reinvested profits (€4 billion).