Financial markets

Financial market setting

Financial markets robust despite negative factors

The financial markets were relatively robust in the first quarter of 2014 despite a raft of negative factors. Although the geopolitical tension surrounding the Ukraine crisis triggered volatile price movements in response to the daily news reports, there was nothing to suggest that the financial market as a whole had been gripped by heightened risk aversion, with the heavy price losses that this normally entails. Even the fresh bout of financial market turbulence which hit a number of emerging markets early in the year tailed off quite quickly. A batch of cyclical indicators which mostly delivered a downside shock up to the end of March likewise had only a muted impact on the markets. The financial markets appeared to be partly shielded from these shocks by the perception of a relatively robust underlying pace of global economic growth and by the persisting expansionary monetary policy stance of the major industrial countries (notwithstanding the US Federal Reserve's gradual tapering of its asset purchases). Moreover, sentiment has brightened again of late. On the whole, this caused bond yields to contract worldwide and the equity markets to post gains predominantly. As the year got under way, the Japanese yen was one of the main winners in the foreign exchange markets, probably on account of its traditional status as a safe haven currency as well as the unwinding of risky carry trades. The euro, meanwhile, saw very little change (-½%) on a weighted average although it is still relatively highly valued.

Exchange rates

Euro exchange rate movements against the US dollar, …

After trading at a rate of US$1.36 at the beginning of February, thereafter the euro appreciated markedly against the US dollar. The trigger for this significant strengthening of the euro was the ECB monetary policy meeting in February, when – contrary to the prevailing expectations of some market participants – it neither decided on nor indicated any further easing measures. The euro received additional support from the publication of surprisingly negative figures on US retail sales and the US property market. After the ECB Governing Council meeting in March maintained its wait-and-see stance, and better-than-expected economic growth figures were announced for the euro area and Germany, the euro-dollar rate climbed further. In mid-March it stood at US$1.39, its highest level for 2½ years.

Subsequently, the euro initially surrendered some of its gains against the US dollar. At this time, comments made by the chair of the Federal Open Market Committee had prompted speculation that the Fed's policy rates might be raised as early as the middle of next year – and thus surprisingly soon. However, at the beginning of April the publication of the minutes of the meeting showed that some members of the Fed's policy committee regarded the latest interest rate expectations as overblown, whereupon the euro strengthened again. In mid-April, the euro drew additional strength from better-than-anticipated figures for German and Spanish industrial output and the smooth issue of a Greek government bond. In the weeks that followed, the euro-dollar rate remained within a narrow range of between US$1.38 and US$1.39 without any clearly discernible trend. Renewed expectations of further easing measures from the ECB have recently put the euro under pressure. As this report went to press, the euro was trading at US$1.37, which was 1% below its level at the beginning of the year.

… the yen …

In the initial weeks of 2014, the euro – in common with a number of other currencies – recorded a significant loss in value against the yen; by mid-February it had fallen to ¥137. Subsequently, after expectations of further monetary easing in the euro area had been damp-

ened, the euro gained markedly against the yen, rising to ¥143 by mid-March; however, it gave up some of these gains in the second half of the month. At the beginning of April, the euro rose again to ¥143. This was caused to an extent by the emergence of speculation that the Japanese central bank would seek to stimulate the economy through additional expansionary monetary policy measures, in view of the increase in value added tax in Japan and the negative impact this could be expected to have on economic activity. However, contrary to these expectations, thus far the Bank of Japan has not engaged in any further easing. Most recently, the euro stood at ¥139, making it about 4% weaker than at the start of the year.

… and against the pound sterling

The euro lost value on balance against the pound sterling during the reporting period. The pound was bolstered by surprisingly favourable figures for the British labour market, a confident economic projection from the Bank of England and property market data. Most recently, the positive economic news culminated in the announcement of a sharp rise in British gross domestic product (GDP) in the first quarter of 2014, which, at 3.1%, was even better than anticipated. As this report went to press, the euro stood at £0.82, which was 2% below its value at the beginning of the year.

Effective euro exchange rate

Since the beginning of 2014, the euro's value vis-à-vis the currencies of 20 major trading partners has fallen by an average of ½%. As well as losing ground against the yen and the pound sterling, as mentioned above, it also declined markedly against the Australian dollar, amongst other currencies. These losses stood in contrast to slight gains against the US dollar and appreciation against the currencies of Canada, China, Hungary and Sweden. Against the backdrop of the conflict in Ukraine, the euro also recorded a distinct strengthening against the Russian rouble and the Ukrainian hryvnia, which are not included in the basket of 20 currencies. The price competitiveness of euro-area suppliers compared with important trading partners has deteriorated somewhat as a result of the euro's appreciation and – measured by the long-term average – is trending at an unfavourable level.

Exchange rate of the euro

Daily data; log scale

Source: ECB. **1** Exchange rate at the start of monetary union on 4 January 1999. **2** As calculated by the ECB against the currencies of 20 countries.
Deutsche Bundesbank

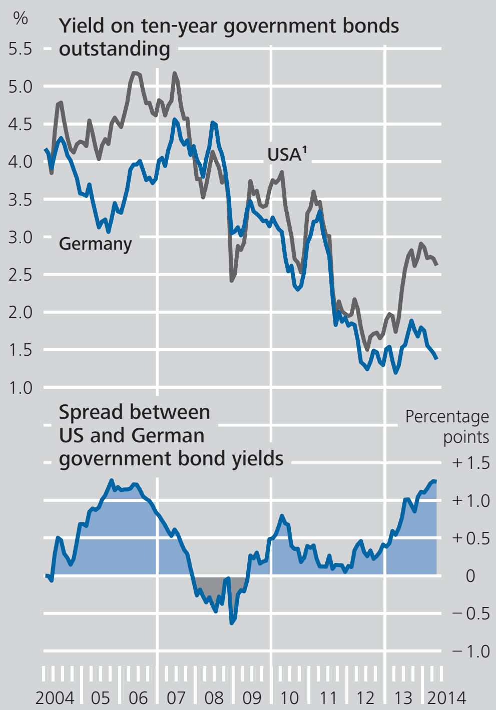
Securities markets and portfolio transactions

Falling yields in the United States, …

Yields on the US bond market dropped significantly in the reporting period. At the beginning of the year, the yield on ten-year US Treasuries was still 3%. This relatively high yield level – compared to those in preceding years – reflected the expectation that the US economy would switch to a steeper growth path and

Bond yields in Germany and the USA

Monthly data



1 Source: Thomson Reuters.
Deutsche Bundesbank

that the US central bank would, as the year progressed, continue with its asset purchase taper initiated in December. Then, low US growth, which came as a surprise for many market participants, and turbulence on the financial markets in some emerging market economies, which triggered increased demand for the safety of bonds, combined to push down yields by 55 basis points overall to 2.5%. The US central bank, meanwhile, did not shift from its path of progressively reducing its monthly asset purchases by US$5 billion per asset class – ie Treasuries and mortgage-backed securities – as it was evident that growth in the first quarter had been held back not least by weather effects.

… in Japan, …

In Japan, too, there was a decline in yields on ten-year government bonds, which fell 15 basis points from a low level at the beginning of the year to reach 0.6%. Since then, Japanese yields have fluctuated within a range of just 7 basis points. Aside from international influences, the reason for the decline in yields can be found in a whole series of worse-than-expected economic indicators, despite strong growth in the real economy in the first quarter caused by expenditure brought forward for tax reasons; the poor figures prompted fears among market participants that the package of measures put together by the government, consisting of monetary policy easing, fiscally induced demand and structural reforms, was not having the desired impact. In addition, the Bank of Japan dominates the bond market, buying huge quantities of government bonds as part of its quantitative and qualitative monetary easing programme, and thus keeps yields at a low level. As a result of price-inelastic demand on the part of the Bank of Japan, which acquires up to 70% of the volume of new issues in the relevant maturity segment, the central bank's balance sheet is continually expanding.

… in the core euro area …

Bonds in the euro area followed the general yield trend. The close tie with US yields made itself felt. In addition, financial market participants are keeping a close eye on current inflation figures in the euro area and are not ruling out further monetary easing from the Eurosystem, despite the gradual pick-up in the euro-area economy. As a result, yields in the core euro-area countries fell even more sharply than in the United States in the reporting period. The yield spread between ten-year US Treasuries and German Bunds expanded by 15 basis points to 120 basis points – the widest it has been for several years.

… and in the euro-area periphery

Since the end of December, the GDP-weighted yield on long-term bonds issued by euro-area countries (not including Germany) has – as in the preceding months – experienced a much sharper fall (of 95 basis points to 2.5%) than the yield on German Bunds. Yields in the periphery countries experienced an above-average decline. One reason for this has been the general investment climate, marked by low interest rates and a pronounced appetite for risk in bond purchases. However, the drop in yields also echoes the fact that critical variables such

as competitiveness and current account deficits are predominantly moving in the right direction in these countries. The rating agencies have adjusted their assessments accordingly and have upgraded Cyprus, Spain, Portugal and Ireland this year. However, the lasting positive growth effects required to secure periphery countries' debt sustainability in the long term are still absent in some countries. On the other hand, the OMT programme, announced but never yet activated, and the financial assistance already furnished or promised, continue to work their effect in the background. That is particularly clear in the case of Greece, where the debt ratio, currently 175% of GDP, is likely to rise again slightly in the current year, according to the European Commission forecast. In 2013, Greece achieved what is called a programme primary surplus, ie a surplus excluding interest payments and crisis-related expenditure such as the cost of recapitalising banks. In this context, the Greek government successfully issued a five-year bond under English law to the value of €3 billion on 17 April 2014, which was most recently yielding just over 5%. This bond issue met with lively interest from private investors abroad, amongst others. This is likely to bespeak both the search for yield and investor confidence in the reiterated assurances from euro-area heads of state and government that the 2012 haircut for Greek bonds held by private creditors constituted a one-off.

Yield curve for German Federal securities flatter

The German yield curve derived from the yields on Federal securities has become flatter by 50 basis points, measured by the yield differential between two-year and ten-year bonds. However, it remains quite steep at 140 basis points. It is mainly the relatively long maturities which have experienced declining yields. Yields on two-year bonds, which are driven to a considerable degree by monetary policy, nonetheless also fell somewhat. This reflects the abovementioned speculation about further monetary easing.

Breaking down the yield curve into its determining components – the real interest rate and

Corporate bond yields in the euro area*

%, weekly averages

Source: Markit. * BBB-rated bonds with a residual maturity of seven to ten years.
Deutsche Bundesbank

inflation expectations – shows that in the reporting period it was primarily the real, ie inflation-adjusted, interest rate which declined – by 45 basis points. The five-year forward inflation rate in five years, a variable favoured by central banks because it is less affected by short-term fluctuations, remains at 2%, and thus close to its value at the start of the year. The corresponding forward inflation rate derived from inflation swaps fell somewhat up to the end of February; most recently it was a little over 2.0%. Therefore, longer-term inflation expectations are to be regarded as firmly anchored in the current interest rate environment.

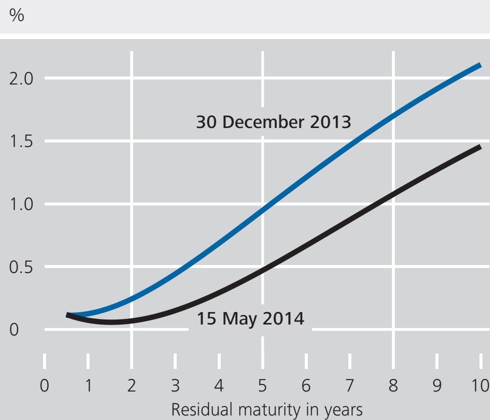
Inflation expectations firmly anchored

Further improvement in financing conditions for enterprises

Financing conditions for enterprises in the capital market have improved still further, underpinning recovery in the euro area. European financials saw their yields on corporate bonds with a residual maturity of seven to ten years and a BBB rating fall significantly from 4.5% at

Yield curve on the German bond market*

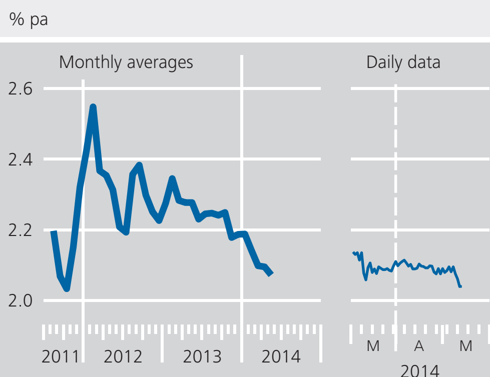
%



* Interest rates for (hypothetical) zero-coupon bonds (Svensson method), based on listed Federal securities.
Deutsche Bundesbank

Five-year forward inflation rate in five years*

% pa



Sources: BGC Partners, Bloomberg and Bundesbank calculations. * Derived from the fixed rate on inflation swaps which is exchanged against annual realised inflation rates (HICP excluding tobacco) in the next five or ten years.
Deutsche Bundesbank

the start of the year to 3.5% latterly.[1] The corresponding bond yields for European non-financial corporations also dropped, from 3.1% to 2.3%. This means that corporate bond yields remained well below their five-year average and distinctly lower than before the outbreak of the financial crisis. In addition, despite the downward movement in German Bund yields, the yield spreads against Bunds with the same maturities narrowed. For financial and real-economy corporations with a BBB rating, the spreads contracted by 40 and 20 basis points to 2.4 percentage points and 1.2 percentage point respectively. Narrower spreads are in keeping with abating uncertainty on the European equity market. They also indicate a further decline in risk aversion amongst bond market participants and quite a low level of investor compensation for expected default losses. Against the backdrop of a continued global low-interest-rate environment, this is likely to be a manifestation of the ongoing search for yield on the part of investors.

Net sales in the bond market up

Gross issuance in the German bond market stood at €395½ billion in the first quarter of 2014, and was therefore up on the previous-quarter level (€366 billion). After deducting significantly higher redemptions and taking account of changes in issuers' holdings of their own bonds, on balance there were net redemptions of domestic bonds to the value of €11½ billion. Nonetheless, foreign borrowers placed debt securities worth €27½ billion on the German market. Thus, funds totalling a net €16 billion were raised in the German bond market in the reporting period.

Public sector borrowing

The public sector raised €4 billion on the bond market in the first quarter of 2014, compared with €9 billion one quarter earlier. The figures also include issues from resolution agencies of German banks which are ascribed to the public sector for statistical purposes. Central government itself issued mainly five-year Federal notes (€13½ billion), and to a lesser extent 30-year Federal bonds (€2½ billion). By contrast, the German Federal government redeemed Federal Treasury discount paper (Bubills) totalling €8½ billion net. In the quarter under review, state governments redeemed their own bonds to the value of €5½ billion in net terms.

Net sales of corporate bonds

In the first quarter of 2014, domestic enterprises issued debt securities worth €2 billion net. As has been the case for some time, domestic firms made use of the favourable financing conditions on the capital market and extended the duration of their liabilities. Whilst they placed €5½ billion worth of bonds with

1 Based on corporate bond yields included in the various iBoxx bond indices for different rating grades.

maturities of over one year on the market, they allowed money market paper with a net value of €3 billion to expire.

Net redemptions by credit institutions

Domestic credit institutions are still in the process of deleveraging. Year-on-year their capital market debt was down €107½ billion, of which €17½ billion was accounted for in the first quarter of 2014. In particular, they redeemed "other bank bonds", which can be structured flexibly (€10 billion), and public Pfandbriefe (€8 billion), as well as mortgage Pfandbriefe (€1 billion). Specialised credit institutions, meanwhile, issued debt securities totalling €1 billion net.

Purchases of debt securities

In the first quarter of 2014, non-resident investors were the main buyers on the domestic bond market; they added paper worth €14½ billion to their portfolios. These were exclusively securities from public sector issuers on balance. Domestic non-banks acquired debt securities for €9½ billion, with foreign paper the focus of investor interest. By contrast, domestic credit institutions and the Bundesbank reduced their portfolios of interest-bearing paper by €5½ billion and €2½ billion respectively.

Equity markets somewhat firmer

In an environment in which positive and negative factors have long been almost evenly balanced, the equity markets in Europe and the United States recorded price gains. At the beginning of the year, financial market tension was engendered mainly by macroeconomic weaknesses and political uncertainty in some emerging market economies; this market tension, in combination with predominantly modest figures for global economic growth, also drove down prices on the international equity markets. However, as the quarter progressed, a global decline in yields on government bonds as well as the prospect of monetary policy continuity in the United States and of a continued low-interest-rate environment helped to stabilise prices. Growing expectations since April of a moderate pick-up in the US economy and some positive economic signals for the euro area and Germany have also boosted momen-

Investment activity in the German securities markets

€ billion

Item	2013 Q1	2013 Q4	2014 Q1
Debt securities			
Residents	1.2	8.1	1.8
Credit institutions	– 14.9	– 0.6	– 5.4
of which			
Foreign debt securities	– 2.7	2.3	5.0
Deutsche Bundesbank	– 4.1	– 2.1	– 2.3
Other sectors	20.1	10.8	9.5
of which			
Domestic debt securities	– 8.3	– 8.0	– 14.8
Non-residents	10.4	– 19.9	14.3
Shares			
Residents	14.0	– 7.0	10.7
Credit institutions	8.3	– 2.2	7.2
of which			
Domestic shares	4.4	– 1.9	5.7
Non-banks	5.7	– 4.8	3.5
of which			
Domestic shares	2.1	– 1.7	1.2
Non-residents	– 5.4	4.9	– 6.0
Mutual fund shares			
Investment in specialised funds	24.5	29.1	20.9
Investment in retail funds	5.0	– 0.5	2.7
of which			
Equity funds	0.0	1.2	– 0.6

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Equity market

Source: Thomson Reuters and Bundesbank calculations.
Deutsche Bundesbank

Discrepancy between changes in net foreign assets and the cumulated financial account: an unsuitable indicator of wealth losses

In the first few years of European monetary union (EMU), increases in net foreign assets could easily be ascribed to cumulated net capital exports as captured in the balance of payments.[1] To a large degree, other determinants such as valuation effects or statistical peculiarities cancelled each other out over time. However, since around 2007, it has been possible to observe a growing discrepancy which by the end of 2013[2] had swollen to €636½ billion.[3] Differences between the cumulated net capital exports[4] and changes in foreign assets are commonly interpreted as an indicator of sizeable losses arising from German foreign investment during the financial crisis.[5] Here, write-downs and value changes are thought to have radically eaten into resident investors' cross-border claims. This has given rise to the argument that German foreign exposures as a whole generate a low yield and are therefore a "bad deal". This view is a fallacy because, when interpreting the discrepancy, it is essential to keep in mind the manifold statistical and methodological differences that exist between the flow accounts used for the balance of payments and the statements of stock used in the international investment position (IIP). In this context, crisis-induced write-downs played a role but were insignificant at the aggregated level. Ultimately, it can be shown that Germany's external assets generated a higher total return than, for example, its external liabilities – both before and during the crisis.

Factors contributing to the discrepancy

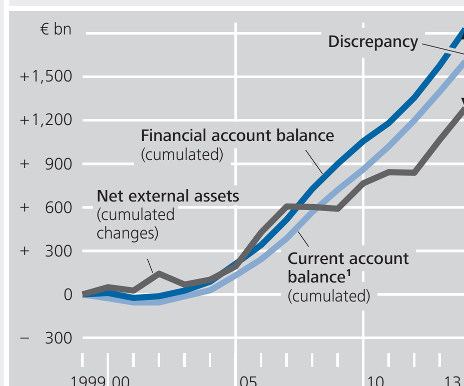
Statistical factors

Statistical factors have led to marked differences between the (cumulated) capital flows and changes in Germany's external assets (which since 2007 have totalled more than €400 billion). For many items, the two accounting systems used for the balance of payments and the IIP are based on different primary statistics. This can result in deviations which, however, simultaneously allow data collection systems to be monitored and improved. Financial derivatives, which for years have been recorded in the balance of payments where they have generated net capital exports, are one example of this. Starting with the monetary financial institutions (MFIs), data on derivatives holdings in Germany have also gradually been collected since 2010 and incorporated into the IIP statistics. Nonetheless, as 2013 came to a close the net financial derivatives item recorded in the IIP stood around €173 billion below the amount that would normally

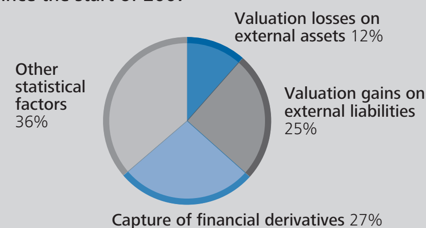
1 See Deutsche Bundesbank, Germany's international investment position since the beginning of monetary union: developments and structure, Monthly Report, October 2008, pp 15-32.
2 According to provisional data relating to the quarterly international investment position.
3 If we take the period commencing with the launch of EMU, the discrepancy narrows to €540 billion because, in the first few years of monetary union, net external assets expanded at a higher rate than that recorded for cumulated balance of payment transactions.
4 Occasionally, this is calculated using the cumulated balances of the current account. The difference between the financial and the current account (including capital transfers) is recorded under the statistical item "errors and omissions" in the balance of payments. Cross-border cash movements, which the statistics have hitherto been unable to reliably capture for the euro area, are of key significance to the (broadly positive) errors and omissions item.
5 See K Klär, F Lindner and K Šehović (2013): Investition in die Zukunft? Zur Entwicklung des deutschen Auslandsvermögens, Wirtschaftsdienst: Zeitschrift für Wirtschaftspolitik, 93 (3), pp 189-197; as well as G Baldi and B Bremer (2013), Verluste auf das deutsche Nettoauslandsvermögen – wie sind sie entstanden?, DIW Weekly Report, No 49, pp 32-40. See also European Commission, Macroeconomic Imbalances – Germany 2014, European Economy, Occasional Papers 174, March 2014, p 72.

have been expected given the cash flows in all sectors since 2007. This discrepancy is mainly attributable to temporarily large-scale purchases by securitisation vehicles of financial derivatives captured in the balance of payments[6] as a means of hedging structured securities issued in Germany (known as certificates).[7] The relevant cross-border transactions relating to the matching certificates are then recorded as portfolio investments. The securities item (which includes the securities deposit statistics) and the equity stakes of direct investment enterprises (which includes the foreign direct investment stock statistics) are another two examples of where different data sources are used. Leaving aside financial derivatives, the combined effect of statistical factors was to reduce the reported figure for Germany's external assets by around €240 billion compared with their expected level after taking into account capital flows.

Financial account, current account and net external assets



Factors contributing to the discrepancy since the start of 2007



1 Including capital transfers.
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Valuation effects

Valuation-related adjustments can be primarily explained by market price and exchange rate effects. Among other things, market price changes can affect securities exposures, real estate, the Bundesbank's gold holdings as well as the equity stakes of listed enterprises. Exchange rate effects, meanwhile, impact on any exposures denominated in foreign currency. Given the typical fluctuations in market prices and exchange rates, valuation effects usually even out over time, at least to some degree. The IIP thus offers no more than a snapshot of the aggregate external position. All in all, market price and exchange rate effects have diminished Germany's net external assets by €233 billion since 2007. The €177½ billion drop in net external assets attributable to market price effects was notably explained by price gains on German bonds held by non-residents. The safe haven status which German bonds enjoyed during the crisis sent non-resident investors flocking to Federal bonds, which also placed additional pressure on their yields and contributed to price gains.

On balance, €55½ billion of the drop in net external assets was explained by exchange rate effects. Between 2007 and 2012, positive and negative exchange rate effects virtually cancelled each other out. In net terms, this means that the exchange rate effect can be almost entirely traced back to the appreciation of the euro during the past year which, on balance, explained the drop in net external assets on account of the higher proportion of positions denominated

6 In future, the IIP should also include derivatives holdings in the corporate sector, which also encompasses securitisation vehicles, the aim being to close another gap in the data collection system.
7 See Deutsche Bundesbank, Certificates and warrants in the balance of payments, Monthly Report, March 2008, pp 26-27.

in foreign currency included in Germany's external assets.

Lasting impairments caused by write-downs and disposals of assets are reflected, for instance, in banks' general provisions for loan losses as a separately captured item. They totalled €37½ billion in the IIP during the financial crisis.

Profitability of German external assets

This section presents two suitable methods for gauging the profitability of external assets – the return on assets (expressed as investment income over external assets), and the total return (which includes valuation effects).

Return on assets

As regards cross-border investment income (which primarily consists of dividends and interest income), since 2004 German investments abroad have outperformed non-residents' assets in Germany. At last count (2013), investment income on German external assets equated to a return of 2.8% compared with just 2.1% on non-residents' assets in the German market.

Total return

Besides considering the income flows recorded in the balance of payments, it is also possible for market price-driven and exchange rate-driven changes included in the IIP as well as valuation allowances made in respect of write-downs to be allocated to the various investment instruments, and to set them in relation to the level of external assets at the start of the period in question. Calculated in this manner, the total return on German external assets averaged 4.0% between 2005[8] and 2013, slightly outperforming the 3.8% total return on non-residents' assets in Germany. Broken down by investment instrument, German direct investment abroad yielded a higher-than-average total return of 7.2%. By contrast, foreign enterprises' direct investment in Germany generated an annual total return of just 4.9%.

Conclusion

To a very large extent, the discrepancy between cumulated net capital flows and the increase in net external assets observed between 2007 and 2013 is not the result of crisis-induced wealth losses but can be explained by differences in statistical data collection methods and by increases in the prices of German external liabilities. All in all, both the return on German external assets and the total return (which also includes valuation effects) exceed the return on external liabilities. What this ultimately indicates is that German investors have fared relatively well with their investment abroad. In any case, it is flat-out inaccurate to say that German foreign investments have performed particularly poorly.

8 A lack of detailed data from earlier years prevents the total return from being calculated for the period before 2005.

tum on the equity markets. Greater confidence in the economy has been reflected on both sides of the Atlantic in some favourable quarterly results from enterprises and in heightened activity in planned mergers and acquisitions. However, in Germany and Europe, the price recovery has contrasted with recurring worries among market participants that the geopolitical conflict surrounding Ukraine and the resultant possibility of economic sanctions against Russia may be detrimental to enterprises.

Marked price gains for European banks

Overall, European and US shares were most recently 2.1% and 1.2% higher respectively than at the end of December as measured by the broad Euro Stoxx and S&P 500 indices. However, shares in the CDAX index lost 0.6% of their value. Bank stocks recorded losses in the United States (-0.9%), whilst rising markedly in the euro area (+3.0%). A factor in these latter gains was probably the anticipatory confidence placed in the periphery countries by market participants in recognition of the structural reform efforts they have initiated, which is likely to have benefited the banks in the form of higher prices for government bonds in the periphery countries. The same confidence has also been reflected on national stock markets in the euro area, with Italian, Portuguese and Irish shares in particular posting large price gains.

Price/earnings ratio higher

The price/earnings ratio, based on 12-month earnings growth expectations, was most recently above or close to its level at the end of December, at 13.7 for the Euro Stoxx and 15.2 for the S&P 500. This, together with falling price uncertainty which remains distinctly below the five-year averages, points to relatively high share valuations. However, valuation levels must be judged in the light of the fact that, with a brightening economic picture, the medium-term earnings growth expectations of European and US enterprises have improved. Applying dividend discount models to the data produces an equity risk premium of 8.3% for the Euro Stoxx index, compared with 7.8% at the end of December. This increase in the risk premium reflects, first, the fact that already

Major items of the balance of payments

€ billion

Item	2013		2014
	Q3	Q4	Q1p
I Current account[1, 2]	+ 45.2	+ 62.9	+ 48.5
Foreign trade[1, 3]	+ 49.8	+ 49.9	+ 47.7
Services[1]	− 5.1	+ 6.2	+ 4.6
Income[1]	+ 19.4	+ 23.4	+ 19.6
Current transfers[1]	− 10.4	− 7.7	− 15.7
II Capital transfers[1, 4]	+ 0.1	+ 1.0	+ 1.8
III Financial account[1] (Net capital exports: –)	− 64.7	− 75.4	− 66.2
1 Direct investment	− 4.0	+ 10.0	− 23.9
German investment abroad	− 8.2	− 9.5	− 22.7
Foreign investment in Germany	+ 4.2	+ 19.5	− 1.2
2 Portfolio investment	− 38.4	− 34.0	− 31.7
German investment abroad	− 32.6	− 23.7	− 40.6
Shares	− 8.7	+ 2.9	− 3.4
Mutual fund shares	− 7.7	− 8.3	− 9.7
Debt securities	− 16.3	− 18.2	− 27.5
Bonds and notes[5, 6]	− 16.6	− 17.7	− 22.6
of which Euro-denominated bonds and notes	− 7.8	− 12.0	− 22.4
Money market instruments	+ 0.3	− 0.5	− 4.9
Foreign investment in Germany	− 5.7	− 10.3	+ 8.9
Shares	+ 4.0	+ 4.2	− 5.3
Mutual fund shares	+ 1.2	+ 5.4	− 0.1
Debt securities	− 10.9	− 19.9	+ 14.3
Bonds and notes[5, 6]	− 5.3	+ 10.9	+ 7.5
of which Public bonds and notes	+ 4.3	+ 16.4	+ 19.3
Money market instruments	− 5.6	− 30.8	+ 6.8
3 Financial derivatives[7]	− 1.2	− 5.5	− 4.5
4 Other investment[8]	− 22.1	− 44.5	− 6.6
Monetary financial institutions[9]	− 15.3	− 63.9	+ 0.8
of which short-term	− 25.9	− 74.7	+ 7.2
Enterprises and households	+ 2.8	− 22.5	− 19.2
of which short-term	+ 8.5	− 12.8	− 15.6
General government	− 11.5	− 9.5	− 6.0
of which short-term	− 10.4	− 6.3	− 8.7
Bundesbank	+ 2.0	+ 51.4	+ 17.9
5 Change in reserve assets at transaction values (increase: –)[10]	+ 0.8	− 1.5	+ 0.6
IV Errors and omissions	+ 19.4	+ 11.5	+ 15.9

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** Adjusted for accrued interest up to and including 2012. **7** Securitised and non-securitised options as well as financial futures contracts. **8** Includes financial and trade credits, bank deposits and other assets. **9** Excluding the Bundesbank. **10** Excluding allocation of SDRs and excluding changes due to value adjustments.

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slightly negative long-term real interest rates, measured on the basis of ten-year Bunds and inflation expectations from surveys (Consensus Forecast), have fallen further. Second, the higher level of compensation required for equity risks indicates a certain degree of caution amongst share market participants, which puts the higher price/earnings ratio in context.

Stock market funding and stock purchases

Issuing activity on the German equity market remained relatively muted in the first quarter of 2014. Domestic enterprises issued €1 billion worth of new shares, the majority of which were listed equities. The volume of foreign equities outstanding on the German market rose by €4 billion. Equities were purchased primarily by German credit institutions (€7 billion), which invested mainly in domestic securities on balance (€5½ billion). Resident non-banks bought shares for €3½ billion, with their main focus on foreign paper. By contrast, foreign investors sold shares in the amount of €6 billion.

Sales and purchases of mutual fund shares

During the reporting period, domestic investment companies recorded inflows of €23½ billion, after raising funds totalling €28½ billion in the previous three months. The fresh funds mainly accrued to specialised funds reserved for institutional investors (€21 billion). Among the asset classes, bond funds were the main issuers of new shares (€12 billion), but mixed securities-based funds (€5½ billion), open-end real estate funds (€2½ billion) and mixed funds (€2 billion) were also active in the market. Foreign funds traded in the German market acquired new resources totalling €9½ billion net in the first quarter of 2014. Domestic non-banks were the main buyers, adding mutual fund shares worth €34 billion to their portfolios. These were domestic shares for the most part. German credit institutions, on the other hand, sold mutual fund shares for €½ billion. On balance, foreign investors had only a marginal involvement in the mutual fund market.

Direct investment

Capital exports in direct investment

As in cross-border portfolio transactions, which recorded a net outflow of funds totalling €31½ billion, net capital exports amounting to €24 billion were registered in the form of direct investment in the first quarter of 2014.

German direct investment abroad

The largest factor in this was the comparatively high level of funding provided by domestic owners to their subsidiaries abroad, amounting to €22½ billion in the first quarter. This mainly took the form of reinvested foreign profits (€11½ billion) and increased equity capital (€8½ billion). Major destinations for German direct investment were the Netherlands (€12½ billion) as well as the United Kingdom and France (€3 billion each).

Foreign direct investment in Germany

Foreign investors slightly reduced their funding of subsidiaries in Germany in the first quarter (€1 billion). On balance, this shrinkage in capital took place exclusively through intragroup credit transactions (€4½ billion). In contrast, foreign parent companies increased their capital in the form of reinvested earnings at German subsidiaries (€3½ billion).