

■ Financial markets

■ Financial market setting

Financial markets impacted by political events and divergent monetary policies

Political events and the monetary policy decisions of the Federal Reserve and the Eurosystem have had a major impact on developments in the international financial markets since September of last year. In addition, rising energy prices contributed to allaying the deflationary concerns of some market participants over the course of the fourth quarter. In early November, the result of the US election, in particular, led to a rapid surge in interest rates across the globe. The reason behind the higher yields was that many market participants expected the new US government to lower taxes and raise government expenditure, which increased the term premium on government bonds. Furthermore, the Federal Reserve – having first raised interest rates at the end of 2015 – announced in December 2016 that it would hike key US interest rates by a further 25 basis points and also reiterated the possibility of a further tightening of monetary policy over the course of this year, if necessary. The interest rate linkage with the United States led to a rise, albeit a smaller one, in yields in the euro area. One reason for this was that the Governing Council of the ECB decided at the start of December to increase the degree of monetary expansion once again. The new measures provide, amongst other things, for securities purchases of €60 billion per month from April 2017 until (at least) the end of December 2017, which is in addition to the purchases already approved until March 2017 under the expanded asset purchase programme (APP). Share prices rose significantly in some cases in this economic and financial market setting, with the US S&P 500 index reaching a new all-time high in mid-February. Financial stocks outpaced the market in many cases – not least on the expectation that the now steeper yield curve would have a positive effect on the earnings position of financial institutions going forward. However, bank shares also benefited from the fact that

the new US government intends to loosen regulatory requirements, which is not unproblematic in view of what happened during the financial crisis. On the foreign exchange markets, interest focused on developments in the US dollar, which recorded significant gains against the currencies of most industrial countries and emerging economies. On a weighted average, the euro fell slightly on balance (-1.4%) against 19 major trading partners. This was largely attributable to depreciation against, in particular, the US dollar and several commodity currencies, which benefited from the recovery in oil prices.

■ Exchange rates

In the fourth quarter of last year, the euro-dollar rate stabilised at over US\$1.10 until the US presidential election on 8 November 2016, after which it came under pressure. The prospect, held out by President-elect Trump, of sizeable tax cuts and investment in US economic infrastructure had led to increasing term premiums, which supported the US dollar on a broad basis. In addition, the US dollar was also strengthened by the publication of unexpectedly favourable economic data for the US economy, while the euro was placed under strain by the constitutional referendum in Italy and related political uncertainty.

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

Following severe market reactions in the immediate aftermath of what was, for many observers, a surprising outcome of the US presidential election, there was a temporary correction on the foreign exchange markets at the end of November, which allowed the euro to recover somewhat. However, in early December the single currency depreciated once again when the ECB Governing Council decided to extend the asset purchase programme with an overall volume that exceeded the expectations of some market participants. While the interest

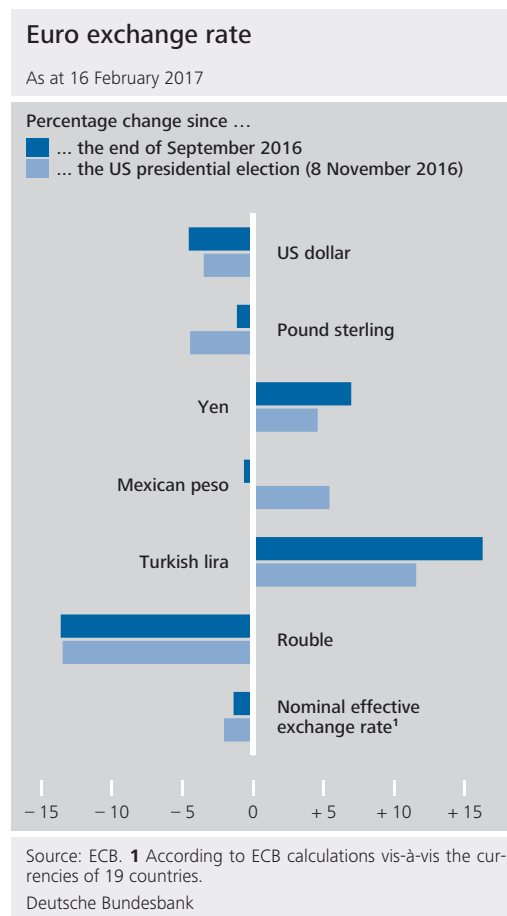
rate hike carried out by the Federal Reserve in mid-December was fully priced into market participants' expectations, the proposed speed of interest rate increases announced at the press conference following the monetary policy meeting was unexpectedly rapid. This caused the euro to fall under the US\$1.04 mark and thus to its lowest level in 14 years. However, the publication at the beginning of January of the minutes of the US Federal Reserve's most recent monetary policy meeting, showing that several members of the Federal Open Markets Committee had warned of the economic consequences of the dollar's strength, dampened any fantasies of soaring US interest rates and buoyed the euro-dollar exchange rate. As this report went to press, the single currency stood at US\$1.07, which is 4.6% below its level at the end of September 2016.

... against the yen ...

Following the US presidential election, the yen weakened markedly against the euro and numerous other currencies – particularly the US dollar – until the end of the year. The main reason for this was that the Japanese central bank has actively managed the yield curve since September of last year and has held the interest rate on ten-year Japanese government bonds close to 0% ever since. By contrast, yields on US government bonds and – via the international interest rate linkage – yields in the euro area and other currency areas have risen substantially since the US presidential election, further widening the yield spread vis-à-vis Japanese government bonds. Meanwhile, the euro-yen rate lacks a clearly discernible trend, moving in a fairly narrow range of between ¥119 and ¥123 since the start of the new year. As this report went to press, the euro stood at ¥121, up 7% on its level at the end of September 2016.

... and against the pound sterling

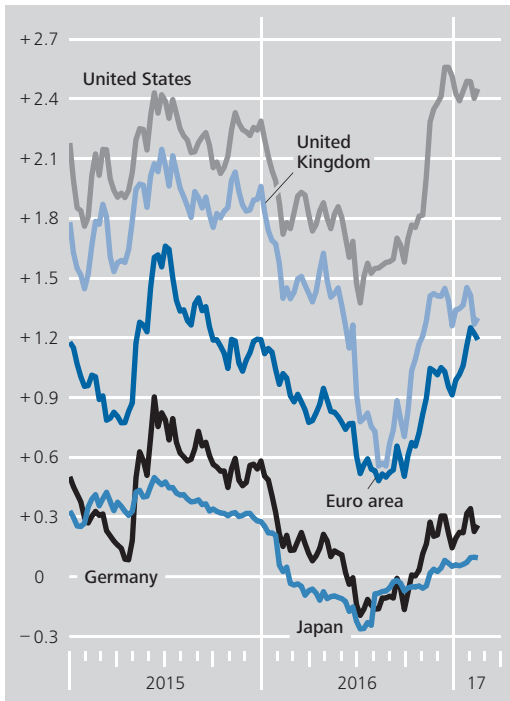
The exchange rate developments in the euro against the pound sterling during the reporting period were driven by shifting assessments of the economic implications of the forthcoming negotiations on the United Kingdom's withdrawal from the EU. The euro initially depreci-



ated against the pound sterling after a court judgement at the beginning of November ruled that the British government could not officially initiate negotiations on the UK leaving the EU on its own, but only with Parliament's consent. On the markets, the judgement had raised hopes that the UK's chief negotiators would pursue a more business-friendly negotiation strategy. However, at the beginning of the year the mood reversed again in favour of the euro, when existing concerns were reinforced that withdrawing from the EU single market was a price the British government was willing to pay in the negotiations and that this would deal a corresponding blow to the UK economy. That said, in the second half of January, the euro lost a large part of its previous gains following a keynote speech in which the UK Prime Minister said she would seek a customs agreement with the EU and comprehensive free trade agreements as part of the exit negotiations. At the end of the reporting period, the euro stood at

Yields* in euro area and selected countries

% pa, weekly averages



Source: Thomson Reuters. * Government bonds with a residual maturity of ten years.
 Deutsche Bundesbank

and refinancing it becomes more expensive when interest rates rise. In addition, concerns about a more protectionist US trade policy and the resulting uncertainty surrounding future trade links were also a factor. For example, the Mexican peso has fallen 8.5% against the US dollar since the US election. The decline experienced by the Turkish lira has been even greater; it has lost 13.5% against the US dollar and 10.4% against the euro over the same period. This is attributable, not least, to the high degree of political uncertainty and terrorist attacks in Turkey. By contrast, the rouble has appreciated by 11.6% against the US dollar and by 15.6% against the euro. The recovery of oil prices is likely to have been a key factor buoying the rouble.

Securities markets and portfolio transactions

Yields on government bonds around the world have moved away from the lows they reached in the summer of last year. Since the end of September 2016, there has been a particularly strong upsurge of 86 basis points in interest rates in the United States. As this report went to press, yields on ten-year Treasuries stood at 2.5%, which is the highest level in roughly two years. The last time yields rose this fast was in the summer of 2013, when market participants surmised that the Federal Reserve might scale back its then asset purchase programme more quickly than they had previously believed. However, changed expectations regarding the stance of monetary policy were not a decisive factor in the recent increase in yields in the United States, with investors continuing to expect a gradual normalisation of the Federal Reserve's key interest rate target. What was decisive was the sharp rise in the term premium, ie the premium that investors receive for purchasing a security with a longer maturity rather than securities with shorter maturities whose redemption and interest payments are continuously reinvested over the investment period. Part of the increase in this premium was due to

Government bond yields higher around the globe ...

... and above all in the United States

£0.85 and thus 1.2% below its level at the end of September 2016.

Effective euro exchange rate

Measured against the currencies of 19 major trading partners, the euro depreciated by 1.4% overall compared with the end of September 2016. Marked gains against the Japanese yen were offset by losses, in particular, against the US dollar and several commodity currencies, which benefited from the rebound in oil prices. The price competitiveness of euro-area suppliers improved somewhat as a result of the euro's depreciation, but in terms of the long-term average the competitive position can currently be regarded as broadly neutral overall.

Currencies of various emerging market economies under pressure following US election

Following the US presidential election, the currencies of key emerging market economies also came under downward pressure vis-à-vis the US dollar. This was partly due to the increase in yields and rising interest rate expectations in the United States, as many emerging market economies hold US dollar-denominated debt

the fact that the higher crude oil prices led to rising inflation, thus helping dissipate deflationary worries. However, political events have been more important, with observers expecting a more expansionary fiscal policy from the new US government. Overall, the ten-year real interest rate in the United States has also risen markedly by just under 70 basis points and is now once again in positive territory.¹

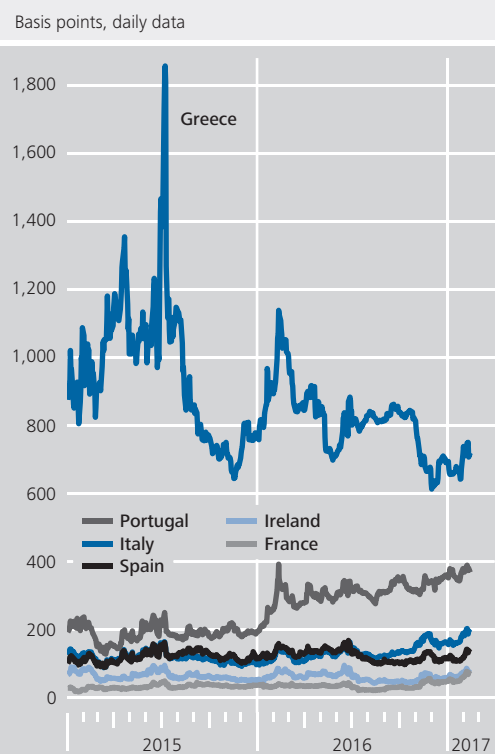
Interest rates on Federal securities rose less strongly

The interest rate linkage with the United States meant that yields on ten-year Federal securities also rose, albeit considerably more mildly (by +53 basis points to 0.3%). One reason why the development is more subdued is that the Eurosystem still has in place an expansionary monetary policy. This can be seen, for example, on the days of the ECB Governing Council decisions of 8 December 2016 and 19 January 2017. Although the yields on Federal bonds did rise somewhat on the days of the ECB Governing Council's monetary policy meetings, these increases were considerably smaller than the gain of just over 10 basis points, overall, that ten-year US Treasuries recorded on these two days. The currently somewhat looser connection is also reflected in the yield spread between the two currency areas' benchmark bonds. At the end of last year, the Treasury/Bund spread reached its widest mark since the start of monetary union, at just over 235 basis points; it is thus currently considerably above its five-year average.

Yields in the United Kingdom also rose starting at the beginning of the fourth quarter of 2016 (+51 basis points), as the economy proved very robust despite the political uncertainty about the modalities of leaving the EU. The smallest rise in yields was in Japan (+17 basis points), where the Japanese central bank had decided in September last year to actively manage the yield curve and maintain the interest rate on ten-year Japanese government bonds close to 0%.

Yield differentials between ten-year Federal bonds and ten-year government bonds of

Spreads of ten-year government bonds over German Federal bonds

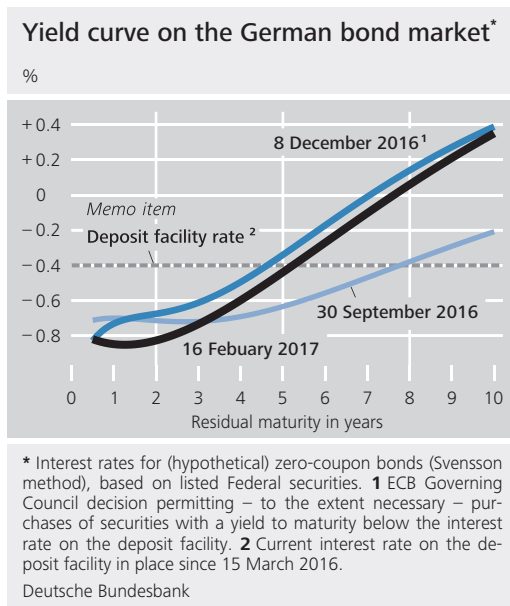


Source: Thomson Reuters.
 Deutsche Bundesbank

other euro-area countries have developed fairly heterogeneously since the end of September 2016, but have risen on the whole. Measured in terms of the GDP-weighted yield of the euro area (excluding Germany), the spread stood at 118 basis points at last count (compared with 90 basis points at the end of September 2016); it was thus also higher than the average of just over 90 basis points since 22 January 2015, the date on which the APP was announced. Country-specific factors are the main reason for the renewed growth in yield spreads in the euro area. In Italy, political uncertainty and the large stock of loans at risk of default held by the Italian banking sector weighed on the prices of government bonds. In mid-January 2017, the last of the four external credit assessment institutions accepted by the Eurosystem lowered its assessment of Italy's creditworthi-

Widening of yield spreads between euro-area countries

¹ The monthly real interest rate is calculated on the basis of nominal daily yields at mid-month and weighted survey-based inflation expectations (Consensus Forecast).



ness by one notch to BBB (high), citing problems in the banking sector. As a result, Italy's yield spread has widened by just over 51 basis points to 180 basis points since September 2016. The prices of French government bonds have also been under pressure, given the growing uncertainty in the run-up to the presidential elections. Here, the yield differential increased by 36 basis points to just under 70 basis points, bringing it above the five-year average (51 basis points). The risk premium on Greek bonds – which, however, are not very liquid and are scarcely traded – changed depending on the regular news reports on the state of negotiations between the Greek government and creditors and remained close to 740 basis points. Further payments will depend on whether the regular programme reviews are successfully concluded. The discussion on the sustainability of Greece's debt has therefore also weighed on prices. The IMF has made its participation in a third assistance package for Greece conditional on a further haircut, which the German government does not regard as necessary in light of the interest rate relief and the extension of maturities already granted.

Yield curve of Federal bonds steepens considerably

The Federal securities yield curve steepened considerably during the period under review. The spread between ten-year and two-year bonds stood at 118 basis points at last count,

considerably higher than at the end of September (50 basis points).² Yields at the short end of the yield curve have fallen slightly again. This was largely due to the ECB Governing Council decisions of 8 December 2016 permitting the Eurosystem to now also purchase securities with a residual maturity of one year. Previously, the minimum remaining maturity was two years. In addition, there has been a loosening of the restriction limiting securities purchases to those with a yield to maturity above the interest rate on the ECB's deposit facility, which currently stands at -40 basis points. This threshold had been binding particularly for Federal securities, in some cases for maturities of up to eight years, and had considerably restricted their eligibility for purchase. According to the December decision, securities with yields lower than the deposit facility rate can now also be purchased if necessary to achieve the APP's monthly purchasing volume. Ultimately, both measures imply a shift in the potential purchasing volume along the maturities spectrum for Federal bonds, from longer term maturities to medium and short-term ones.

On balance, market-based inflation expectations increased in the period under review. The five-year forward inflation rate in five years derived from swaps for the euro area, which had been 1.35% at the end of September 2016, stood at 1.77% as this report went to press. The forward inflation rate in the United States followed a similar trend, increasing by 42 basis points to 2.44%. The virtually identical upward trajectory of market-based inflation measures in both currency areas suggests that global factors such as rising commodity prices and higher risk premiums are likely to have been the key drivers behind these developments. Survey-based measures of inflation expectations six to ten years ahead came in most recently at just under 1.9% in the euro area and just under 2.3% in the United States. Infla-

Forward inflation rates rise

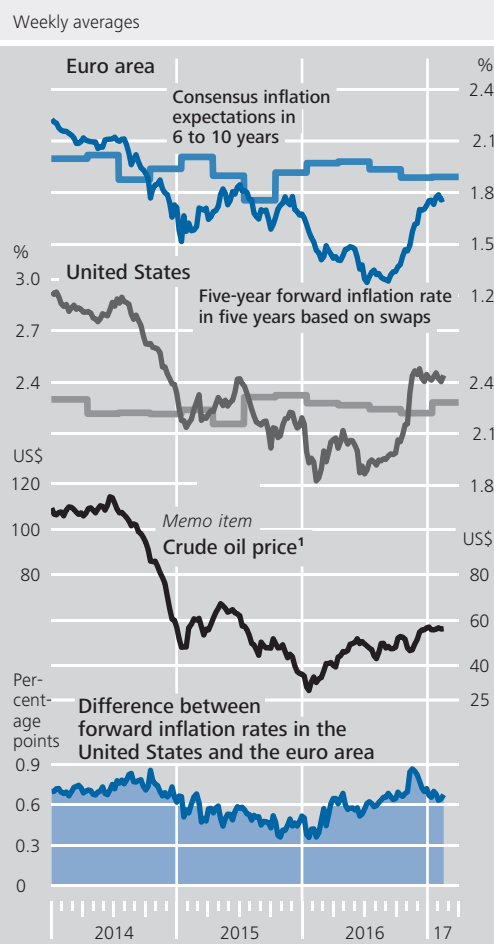
² On average, the yield differential between ten-year and two-year bonds since the start of monetary union stands at just over 120 basis points.

tion risk premiums, which can be approximated by the difference between survey-based and market-based inflation expectations, have risen significantly and are now only slightly negative (euro area) or have even turned positive again (United States). The concerns about deflation expressed by some investors, which had throughout much of 2016 resulted in markedly negative inflation risk premiums, have now dissipated for the most part.

Financing conditions for enterprises remain very favourable despite higher interest rates

On balance, yields on European corporate bonds continued to rise, having initially embarked on this upward path in the middle of 2016. Yields on corporate bonds with a residual maturity of seven to ten years and a BBB rating latterly stood at 2.0%, 40 basis points higher than at the end of September 2016. Compared with their five-year average of just over 3%, however, the financing conditions for these enterprises remain highly favourable by historical standards. Corporate bond spreads developed differently depending on the sector in question. While the yield spreads of BBB-rated non-financial corporate bonds with a residual maturity of seven to ten years over Bunds of the same maturity increased slightly by 12 basis points to 1.5 percentage points compared with the end of September 2016, the corresponding spreads of corporate bonds in the financial sector narrowed by 22 basis points to 2.9 percentage points. In addition to this, in an environment of rising capital market yields, returns on high-yield bonds came down, falling to all-time lows. Aside from the improved economic outlook and diminishing risk aversion, this development was probably also driven by the Eurosystem's corporate sector purchase programme (CSPP), under which the Eurosystem purchases debt securities issued by non-financial corporations with high credit quality ratings.³ In this context, portfolio rebalancing effects also have an impact on the yields of bonds not eligible for the asset purchase programme such as those issued by financial enterprises and entities with a poor credit rating.

Forward inflation rates* and expectations in the euro area and the United States



Sources: Bloomberg, Thomson Reuters, Consensus Economics and Bundesbank calculations. * Derived from the fixed cash flow arising from inflation swaps which is swapped for the actual annual inflation rates (HICP excluding tobacco for the euro area and CPI Urban Consumers for the United States) realised over the next five or ten years. ¹ Brent blend (for delivery in one month).
 Deutsche Bundesbank

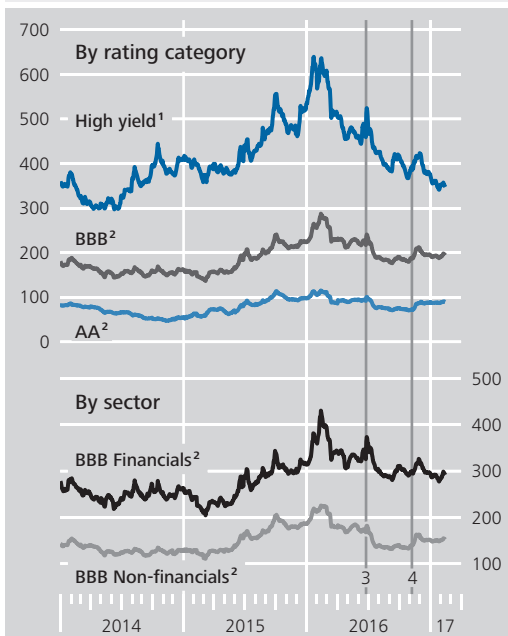
Gross issuance in the German bond market in the fourth quarter of 2016 was well down on the previous quarter. Overall, German borrowers issued paper worth €231 billion, compared with €310 billion in the preceding three months. Net of redemptions and changes in issuers' own holdings, domestic issuers reduced their capital market borrowing by €26 billion. The outstanding volume of foreign debt securities in the German market fell by €14 billion in the fourth quarter. On balance, the total outstanding volume of bonds in Germany thus

Net redemptions of German debt securities

³ See Deutsche Bundesbank, Financial markets, Monthly Report, August 2016, p 43.

Yield spreads of corporate bonds in the euro area*

Basis points, daily data



Sources: Thomson Reuters and Bundesbank calculations.
 * Compared with Federal securities with residual maturity of seven to ten years. **1** Merrill Lynch index across all maturities.
2 In each case, iBoxx indices with residual maturity of seven to ten years. **3** Brexit referendum. **4** US presidential election.
 Deutsche Bundesbank

Investment activity in the German securities markets

€ billion

Item	2015		2016	
	Q4	Q3	Q3	Q4
Debt securities				
Residents	- 1.2	34.6	17.6	
Credit institutions	- 48.4	- 24.2	- 19.6	
of which				
Foreign debt securities	- 1.1	- 14.1	- 6.1	
Deutsche Bundesbank	36.6	48.9	49.5	
Other sectors	10.5	10.0	- 12.3	
of which				
Domestic debt securities	3.6	- 5.1	- 1.7	
Non-residents	- 54.5	- 27.9	- 57.4	
Shares				
Residents	6.9	12.1	2.7	
Credit institutions	1.4	0.6	1.8	
of which				
Domestic shares	0.1	0.1	3.5	
Non-banks	5.5	11.4	0.9	
of which				
Domestic shares	- 2.5	0.4	- 8.4	
Non-residents	5.0	1.2	6.6	
Mutual fund shares				
Investment in specialised funds	30.6	17.4	33.8	
Investment in retail funds	11.0	3.8	6.0	
of which				
Equity funds	6.4	1.9	3.4	

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shrank by €40 billion in the quarter under review.

German credit institutions reduced their capital market debt by €15 billion in the reporting quarter, by redeeming mainly debt securities issued by specialised credit institutions (€8 billion). In addition, volumes of public Pfandbriefe and other bank debt securities which can be structured flexibly fell to the tune of €3½ billion in each case, while mortgage Pfandbriefe were also redeemed in net terms, although volumes were smaller.

Fall in credit institutions' capital market debt

The public sector redeemed debt instruments totalling €15 billion net in the quarter under review. The Federal government and the resolution agency classified as part of central government redeemed five-year Federal notes (Bobls; €9½ billion), Treasury discount paper (Bubills; €7 billion) and two-year Federal Treasury notes (Schätze; €6 billion). This contrasted with net issuance of 10 and 30-year Bunds in the amount of €7½ billion and €1½ billion respectively. State governments issued debt securities with a net value of €2 billion.

Net public sector redemptions

In the fourth quarter of 2016, domestic enterprises issued bonds worth €4 billion net. On balance, most of this issuance was long-term paper, with non-financial corporations, in particular, issuing debt securities. Meanwhile, other financial institutions scaled back their debt borrowing.

Net issuance of corporate bonds

The Bundesbank was the sole net purchaser of debt securities in the fourth quarter of 2016. Under the APP, it acquired instruments worth €49½ billion net, principally in the form of public sector bonds (€43½ billion). Domestic credit institutions and non-banks disposed of paper worth €19½ billion net and €12½ billion net respectively. While the credit institutions chiefly parted with German instruments, the non-banks mainly sold foreign securities. Foreign investors offloaded domestic fixed-income securities in the amount of €57½ billion net. The bulk of this was again accounted for by

Purchases of debt securities

public debt securities (€50 billion), some of which were acquired by the Bundesbank.

Clear gains on international stock markets

During the period under review, the international stock markets were driven by the expectation that global growth would gradually strengthen in the course of 2017. The broad S&P 500 equity index in the United States rose by 8.3% compared with the end of September 2016 and reached a new all-time high in mid-February, largely on the back of the healthy US economy along with expectations of future economic growth measures courtesy of the new US administration. In addition, analysts upped their projection of 12 months earnings per share by 3.6%, while their assessments of long-term earnings growth (over three to five years) deteriorated somewhat by 0.3 percentage point. The largely positive surprises revealed in the first few quarterly reports recently published by US firms confirmed the positive outlook in the short term. The Federal Reserve's decision to raise its policy rate in December, on the other hand, did not dampen stock market developments perceptibly. Against the backdrop of higher inflation expectations, possible further rate increases during 2017 seem to have been priced in.

The prospect of a continued economic upturn in the euro area drove up European stock prices, as demonstrated by the broad Euro Stoxx index, which gained 9.3%, thus outperforming its US counterpart. Analysts' forecasts of earnings per share 12 months ahead rose by 4.4% over the reporting period. The equity risk premium, which is determined for the Euro Stoxx on the basis of a dividend discount model, contracted by almost 77 basis points on balance and is now slightly below its five-year average. Increases in German shares heavily influenced the direction of the European equity market. Compared with the end of September 2016, the CDAX recorded price gains of 10.4%. Political uncertainty in a number of European countries therefore hardly dampened developments in the market as a whole. Compared with their respective five-year averages, earn-

Equity market

Weekly averages



Sources: Thomson Reuters and Bundesbank calculations. **1** Implied equity risk premiums determined using dividend discount models on the basis of profit and dividend expectations (I/B/E/S). **2** Brexit referendum. **3** US presidential election. Deutsche Bundesbank

ings yields on both sides of the Atlantic suggest that shares are fairly highly valued.

Against the backdrop of more stable economic growth and the yen's weak external value, the Japanese stock market also remained on the upward trajectory it had embarked upon in the summer. Of the indices of all major economies, the Nikkei saw the strongest growth during the period under review and stood 17.6% above its level of the end of September 2016 as this report went to press. Given the country's robust economic outlook, the UK decision to leave the European Union and the ongoing uncertainty about its future links to the EU

Japanese stock market sees strong rise

Major items of the balance of payments

€ billion

Item	2015		2016	
	Q4	Q3	Q4P	
I Current account	+ 72.2	+ 61.2	+ 68.4	
1 Goods ¹	+ 64.1	+ 67.9	+ 62.5	
2 Services ²	- 6.7	- 12.9	- 4.7	
3 Primary income	+ 24.9	+ 16.8	+ 22.4	
4 Secondary income	- 10.0	- 10.7	- 11.8	
II Capital account	- 2.2	+ 0.4	- 0.1	
III Financial account (increase: +)	+ 58.3	+ 57.7	+ 74.4	
1 Direct investment	+ 25.5	+ 12.5	+ 29.1	
Domestic investment abroad	+ 29.6	+ 21.3	+ 21.5	
Foreign investment in the reporting country	+ 4.1	+ 8.7	- 7.6	
2 Portfolio investment	+ 66.8	+ 48.8	+ 50.8	
Domestic investment in foreign securities	+ 17.7	+ 19.8	- 0.7	
Shares ³	+ 7.6	+ 8.2	+ 3.4	
Investment fund shares ⁴ of which	+ 4.6	+ 8.9	+ 9.9	
Money market fund shares	- 1.7	- 0.5	+ 2.6	
Long-term debt securities ⁵ of which	+ 6.0	+ 5.9	- 9.8	
Denominated in euro ⁶	+ 2.5	- 4.4	- 7.8	
Short-term debt securities ⁷	- 0.5	- 3.1	- 4.1	
Foreign investment in domestic securities	- 49.1	- 29.0	- 51.4	
Shares ³	+ 4.9	+ 1.2	+ 6.4	
Investment fund shares	+ 0.6	- 2.3	- 0.4	
Long-term debt securities ⁵ of which	- 32.6	- 23.9	- 29.1	
Issued by the public sector ⁸	- 18.8	- 20.0	- 43.0	
Short-term debt securities ⁷	- 21.9	- 4.0	- 28.3	
3 Financial derivatives ⁹	+ 5.5	+ 10.0	+ 13.3	
4 Other investment ¹⁰	- 39.2	- 13.4	- 18.7	
Monetary financial institutions ¹¹	- 11.2	- 30.4	+ 22.3	
Enterprises and households ¹²	- 28.0	+ 12.2	- 28.9	
General government	- 2.0	+ 7.9	- 2.1	
Bundesbank	+ 2.0	- 3.2	- 10.0	
5 Reserve assets ¹³	- 0.3	- 0.3	0.0	
IV Errors and omissions ¹⁴	- 11.7	- 4.0	+ 6.1	

1 Excluding freight and insurance costs of foreign trade. **2** Including freight and insurance costs of foreign trade. **3** Including participation certificates. **4** Including reinvested earnings. **5** Long-term: original maturity of more than one year or unlimited. **6** Including outstanding foreign D-Mark bonds. **7** Short-term: original maturity up to one year. **8** Including bonds issued by the former Federal Railways, the former Federal Post Office and the former Treuhand agency. **9** Balance of transactions arising from options and financial futures contracts as well as employee stock options. **10** Includes in particular financial and trade credits as well as currency and deposits. **11** Excluding the Bundesbank. **12** Includes the following sectors: financial corporations (excluding monetary financial institutions) as well as non-financial corporations, households and non-profit institutions serving households. **13** Excluding allocation of special drawing rights and excluding changes due to value adjustments. **14** Statistical errors and omissions, resulting from the difference between the balance on the financial account and the balances on the current account and the capital account.

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hardly affected the British stock market. The FTSE All-Share index was up by 5.5% from September 2016 and marked an all-time high at one point.

Stock markets were driven not only by assessments of global economic developments, sector-specific events also had a major impact. In the banking sector, the recovery observed in the previous quarter continued apace. At 26.7% and 37.8% respectively, bank stocks in the euro area and the United States rose appreciably. Nevertheless, the projection of 12 months earnings per share fell significantly short of actual share price growth. This led to a sharp decline in the equity risk premium, calculated on the basis of a dividend discount model, in the order of 2.5 percentage points in the euro area and of 1.3 percentage points in the United States. The resolution of legal disputes affecting individual institutions in Germany as well as first injections of liquidity for ailing Italian banks are likely to have helped boost prices in the euro area, as did the anticipated improvement in banks' earnings situation as a result of the steepening of the yield curve. The recent publication of disappointing quarterly reports by a number of European banks, on the other hand, has somewhat dampened market dynamics in the euro area. In the United States, the administration's announcement of its intention to roll back banking regulations gave rise to an upbeat mood in the markets. This was also reflected in the US banking sector's equity risk premium, which has fallen below the level for the market as a whole.

Bank sectors record strong price gains on both sides of the Atlantic

Uncertainty among market participants regarding further stock market developments – as measured by the implied volatilities of equity indices calculated from options – has receded considerably around the world since the US presidential election, more than offsetting the spike in uncertainty witnessed in the run-up to the election. In the United States, price uncertainty has thus returned to a level last seen before the onset of the financial crisis. Heightened political uncertainty across the globe has

Reduced price uncertainty in the stock market despite greater political uncertainty

thus far evidently failed to translate into stock price uncertainty.

Stock market funding at low level

On balance, funding raised on the German stock market totalled €1½ billion in the final quarter of 2016. The volume of foreign shares in the German market rose by €7½ billion over the same period. Equities were purchased primarily by foreign investors (€6½ billion). Domestic credit institutions added €2 billion worth of equities to their portfolios, all of which were German shares on balance. Resident non-banks bought shares for €1 billion net, with a particular focus on foreign securities.

Sales and purchases of mutual fund shares

In the final quarter of 2016, domestic investment companies recorded a net inflow of €40 billion, compared with €21 billion in the previous quarter. On balance, the vast majority of the fresh funds were channelled to specialised funds reserved for institutional investors (€34 billion). Of the various asset classes, mixed securities funds, in particular, registered large net inflows of capital (€21 billion), as did, albeit to a lesser extent, open-end real estate funds (€6 billion), equity funds and funds of funds (€5½ billion each). The outstanding volume of foreign mutual fund shares in Germany rose by €10 billion in the period under review. On balance, investment fund shares were bought exclusively by domestic non-banks, which added paper worth €51½ billion to their portfolios in net terms. Most of this paper was issued by domestic mutual funds. By contrast, German credit institutions and non-resident investors sold paper totalling €1½ billion and €½ billion net respectively.

lion in the fourth quarter of 2016, net capital exports were likewise recorded in the field of direct investment; these amounted to €29 billion.

Direct investment sees capital exports

Direct investment abroad by German enterprises came to €21½ billion net in the final quarter of 2016. Domestic investors boosted their equity capital in subsidiaries abroad by €17 billion. To some extent, reinvested earnings contributed to this development (€2 billion). In addition, domestic enterprises stepped up their intra-group lending by €4½ billion, of which €2½ billion were used to expand trade credits and €2 billion as a means to grant additional financial loans. Countries receiving substantial direct investments from Germany included the United States (€5 billion), China and Luxembourg (€3½ billion each).

German direct investment abroad

Foreign investors scaled back their direct investment in Germany from October to December 2016 by €7½ billion, largely by reducing claims arising from debt instruments (-€7½ billion). Redemptions of financial credits (€13½ billion) were partially balanced out by an increase in trade credits (€6 billion). Meanwhile, the level of equity capital held by foreign direct investors in Germany fell by €½ billion as the liquidation of existing equity capital was not fully compensated by new investments and reinvested earnings. In regional terms, investors based in Luxembourg (-€11 billion), Switzerland and Ireland (-€1½ billion in each case) downscaled their direct investment in Germany. Other countries, meanwhile, including the United Kingdom (€3½ billion), made additional direct investment.

Foreign direct investment in Germany

■ Direct investment

As with cross-border portfolio investment, which saw net outflows to the tune of €51 bil-