Financial markets

Financial market setting

Financial markets influenced by heterogeneous growth rates and differing monetary policy stances

In the second quarter and the early part of the third quarter, international financial markets reflected the overall robust global economic growth, the intensity of which varied, however, from one currency area to the next. Monetary policy decisions, along with expectations of the future economic policy stance, also showed evidence of these differences. For example, the US Federal Reserve continued its policy of gradually raising its benchmark interest rate. Furthermore, whereas at the end of March only one interest rate move had been expected for the second half of 2018, the sound outlook for the economy at the end of the reporting period meant that two interest rate moves over the rest of the year were seen as the most likely scenario. By contrast, at last report the euro area was not expected to see its first policy rate increase until the second half of 2019. This was due in large measure to the ECB Governing Council's communication of mid-June, which was perceived as being accommodative. Concern about how the trade conflicts between the major economic areas would unfold, uncertainty about the thrust of the new Italian government's policy, and the collapse of the Turkish lira prompted bouts of safe haven flows. (Implied) volatility in the various financial markets spiked at times, but hovered close to its long-term average overall. On balance, yields on ten-year Federal bonds (Bunds) dropped to 0.3%, whereas yields on ten-year US Treasuries rose to 2.9%. The yield spread between these two instruments stood at 260 basis points for a time, the widest it has been since the end of the 1980s. The GDP-weighted yield for the euro area excluding Germany climbed to 1.4%, largely on the back of an increase in yields on Italian government bonds. Yields on euro area corporate bonds also edged higher. Equity markets largely mirrored the upbeat path of the economy, though in the euro area the aforementioned political uncertainties did put a damper on price momentum. On a weighted average against the currencies of 19 major trading partners, the euro slipped slightly on balance.

Exchange rates

Euro down against the US dollar, …

In foreign exchange markets, the euro's exchange rate put in a mixed performance between the end of March and mid-August, with the euro depreciating markedly against the US dollar. Owing to diverging economic prospects on each side of the Atlantic, the euro was already beginning to lose value against the US dollar in mid-April 2018. This fall in the value of the euro was given additional momentum in May in connection with the uncertainty over whether it would be possible to form a government in Italy. At the same time, the vote of no confidence against the then Spanish Prime Minister weighed on the euro. The euro had a value at the end of May of US$1.16, its lowest level since July 2017.

Only when an Italian government began to emerge did the euro begin to recoup some of the losses it had incurred against the US dollar. Further tailwinds came from surprisingly high inflation figures for Germany and Italy, which appear to have been interpreted by market players as signalling a possible reduction in the Eurosystem's extraordinary monetary policy stimulus. The euro was given additional lift by statements from the ECB Governing Council hinting that there would be a discussion on the continuation of the asset purchase programme at its monetary policy meeting at the beginning of June. However, these gains began to erode again following the meeting. While the ECB Governing Council announced a timetable for ending the net asset purchases, policy rates are set to remain at their present levels at least through the summer of 2019. This decision came as a surprise to many market participants and weighed on the euro.

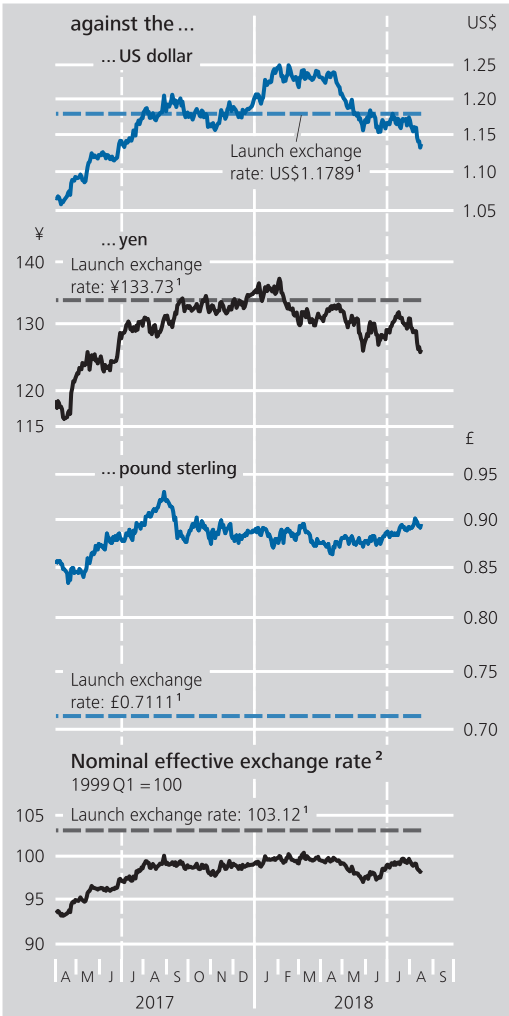
Thereafter, the euro-dollar rate hovered between US$1.15 and US$1.18. On this side of the Atlantic, agreement on the disbursement of further financial assistance to Greece and some surprisingly upbeat sentiment indicators buoyed the single currency. For example, the Purchasing Managers' Index for the euro area and the Ifo business climate index for the German economy were unexpectedly favourable. This was counterbalanced, however, by some likewise surprisingly positive US economic data. Furthermore, the Chair of the Federal Reserve, Jerome Powell, firmed expectations of further interest rate hikes in 2018 in his speech before the US Senate. At the end of the reporting period, the euro was trading slightly lower again at US$1.14, down by around 7.7% on its level at the end of March.

… and the yen, …

After a period of only minor fluctuations, the euro came under marked pressure against the yen in May. Headwinds included the aforementioned publication of surprisingly weak economic data for the euro area, as well as the bouts of political uncertainty in Italy and Spain. At the end of May, the euro stood at approximately ¥126, its lowest level since June 2017. As the political prospects in these European countries brightened and inflation figures for the euro area came in higher than expected, this price movement reversed. In addition, a handful of unexpectedly weak economic numbers were reported for Japan. Both gross domestic product (GDP) growth in the first quarter of the year and the rise in consumer prices in June fell short of market participants' expectations. At the end of July, the monetary policy decisions taken by the Bank of Japan surprised some market participants, who had evidently been expecting a less expansionary stance. However, this only strengthened the euro against the yen for a short time. This was partly because the initial estimate of Japanese economic growth in the second quarter was higher than the majority of market participants had expected. As this report went to press, the euro stood at ¥126, down 3.9% on its level at the end of March.

Exchange rate of the euro

Daily data, log scale



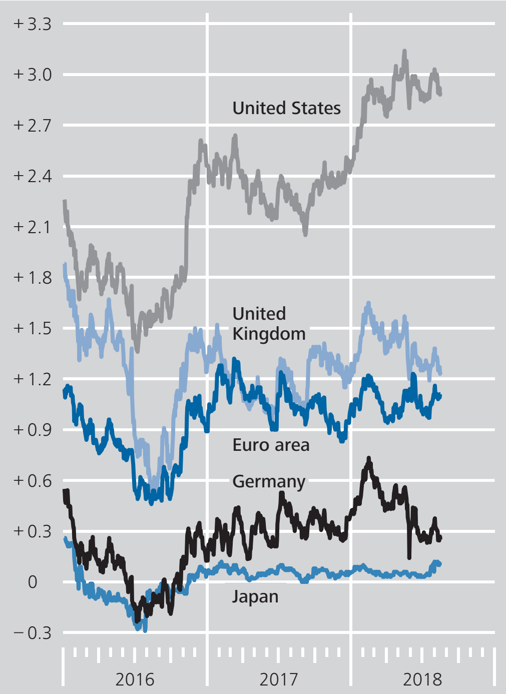
Source: ECB. 1 Exchange rate at the start of monetary union on 4 January 1999. 2 As calculated by the ECB against the currencies of 19 countries.
Deutsche Bundesbank

… but up against the pound sterling

From the beginning of May until the end of June, the euro's exchange rate hovered at a level between £0.87 and £0.88 without any lasting price changes for this currency pair. However, at the end of June, statements from the Bank of England calling into question the need for higher interest rates in the United Kingdom placed the pound sterling under pressure. While the continued uncertainty surrounding the negotiations over the United Kingdom's withdrawal from the European

Bond yields* in the euro area and selected countries

% pa, daily data



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

Union did not initially seem to have any lasting influence on the EUR-GBP exchange rate, the euro continued to appreciate when economic data from the United Kingdom in mid-July disappointed market observers and a no-deal Brexit came to be seen as a more likely scenario. As this report went to press, the euro stood at £0.89, up 2.3% on its level at the end of March.

Euro depreciates slightly in effective terms

Overall, the euro depreciated slightly on a weighted average against the currencies of 19 major trading partners (down 1.2% on balance), even if it did appreciate against individual currencies such as the renminbi (+1.2%). Factors weighing on the Chinese currency included the trade dispute with the United States. Outside the group of 19 partner currencies, the euro recorded considerable gains against the Turkish lira (+35.5%). Various monetary policy measures were taken, but none succeeded in braking the lira's depreciation for more than a temporary period. Market participants wondered at times how much room for manoeuvre the Turkish central bank actually has. Since the beginning of August, the lira has been plumbing ever greater depths against the euro, after the United States imposed sanctions on two Turkish ministers and a trade conflict erupted between these two countries.

Securities markets and portfolio transactions

Government bond yields rose initially around the world

Government bond yields in the various currency areas saw mixed developments from the end of March. They initially rose worldwide via the interest rate linkage with the United States until mid-May. This was primarily a result of the temporary increase, most notably in the United States, in term premiums – that is, the premiums that remunerate investors who are willing to hold securities with longer residual maturities. One reason for this, besides the comparatively robust pace of economic growth, was US government debt, which the Congressional Budget Office estimates will grow significantly in the future in the wake of the tax reform.

Politically induced safe haven flows seen for a time

In mid-May, financial market participants' concerns about how the political situation in Italy would unfold led to safe haven flows, though these then reversed again rather quickly. Within the space of a week, yields on benchmark paper fell significantly in the major currency areas, above all in the euro area. They rose again thereafter, but without returning to their initial levels. Towards the end of the reporting period, the sharp depreciation of the Turkish lira and related concerns about the solvency of Turkish debtors who have taken out loans denominated in foreign currency prompted a further flight into safe assets.

Trade disputes influence yields, depending on news reports

Recent months have seen US trade policy, which market observers have considered increasingly confrontational and erratic, repeatedly have an influence on yield movements. At the end of July, the joint statement by the

US President and the President of the European Commission on sounding out the scope for a trade agreement temporarily led to a certain easing. However, almost at the same time, there were growing signs that the trade dispute between the United States and China could intensify. Overall, though, uncertainty in bond markets, as measured by the implied volatility of options, remained within fairly narrow bounds. One reason for this could be that this ratio has a relatively short expectation horizon of three months, which makes it less suited to modelling potential long-term negative consequences for the world trade framework.

On balance, yield on ten-year US Treasuries up and …

On balance, the yields on ten-year US Treasuries climbed 13 basis points over the period under review to 2.9%. Looking at the entire period under review, the main reason for this was – as mentioned at the outset – that, overall, monetary policy interest rate expectations increased against the backdrop of the favourable economic data for the United States.

… yield on ten-year Bunds down

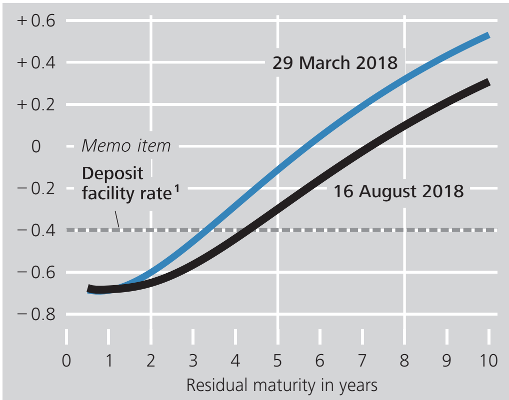
By contrast, the yield on ten-year Bunds has fallen to 0.3% since the end of March. In addition to the dwindling term premium, the expected monetary policy also contributed to this. Against this backdrop, the spread between the United States and Germany widened to 257 basis points at last count.

Downward shift in yield curve

From the end of March, the yield curve derived from the yields on Federal securities twisted downwards at the long end, while short-term interest rates remained virtually constant. Interest rates up to a maturity of seven years were in negative territory at last count. The announcement by the ECB Governing Council in June to prospectively reduce the monthly pace of the net asset purchases under the expanded asset purchase programme (APP) to €15 billion as of October and to discontinue them at the end of the year was largely in line with market expectations. One surprise for market participants, however, was the news that the ECB Governing Council decided at the same meeting to keep the deposit facility rate at its current level at least through the summer of 2019. This caused the yield curve to shift somewhat downwards. At the end of the reporting period, the yield curve, as measured by the spread between ten-year and two-year yields, was 17 basis points flatter than at the end of March.

Yield curve on the German bond market*

% pa



* Interest rates for (hypothetical) zero-coupon bonds (Svensson method), based on listed Federal securities. 1 Current interest rate on the deposit facility in place since 15 March 2016.

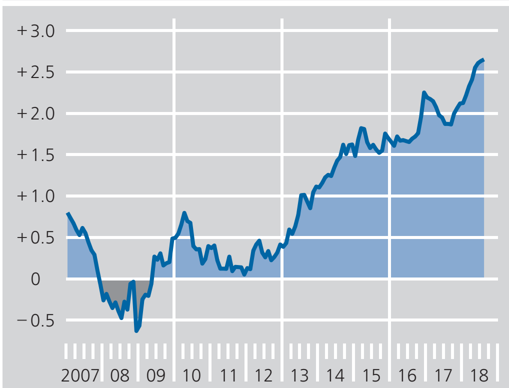
Deutsche Bundesbank

Widening of yield spreads in the euro area

The yield spread between ten-year Bunds and ten-year government bonds of other euro area countries (GDP-weighted average) widened by 48 basis points. The main reason for this was the uncertainty surrounding the monetary and fiscal policy stance that the new Italian government would take; starting in mid-May this led

Yield spread between US and German government bonds*

Percentage points, monthly data

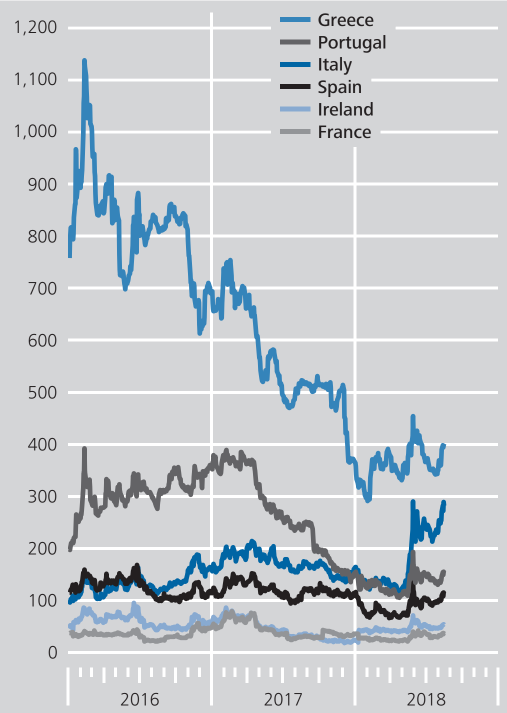


1 Source: Bloomberg. * Yield spread of US Treasuries over Bunds, each with a residual maturity of ten years.

Deutsche Bundesbank

Spreads of ten-year government bonds over German Bunds

Basis points, daily data



Sources: Bloomberg and Bundesbank calculations.
Deutsche Bundesbank

to a widening of yield spreads, particularly of Italian paper over Bunds. At last count, the yield spread of Italian bonds was still well above its end-of-March level, measuring 282 basis points. Creditors of the Italian government are evidently following the domestic debate closely and are demanding compensation for possible longer-term political risks. The yield spreads of government bonds from other euro area countries over German Bunds also widened during the period under review. On the whole, the yields of countries with lower credit ratings rose more sharply. One exception to this were Greek sovereign bonds, whose yields changed little on balance following the finalisation of deliberations on the forthcoming end of the third Economic Adjustment Programme for Greece and a subsequent upgrading by the rating agencies Standard & Poor's and Fitch. Overall, the yield spread between bonds increased more sharply than the corresponding costs for credit default swap contracts – which are, in effect, insurance which market participants can take out to hedge their exposure to default risk. The wider spread is presumably an indication of higher liquidity premiums for Federal securities. The fact that the spread of bonds issued by the KfW banking group (Kreditanstalt für Wiederaufbau) over Bunds has also widened would certainly suggest that this is the case.[1]

Yields in the United Kingdom and Japan see little change

At 1.2%, yields on ten-year UK gilts were somewhat down on the end of March at last count. The Bank of England's decision at the start of August to raise its policy rate had no discernible impact on long-term yields. The dispute within the UK government over how the country should withdraw from the EU likewise did not trigger any movements of note in the bond markets. The yield on ten-year Japanese government bonds, meanwhile, climbed to 10 basis points, leaving it 5 basis points higher than at the end of March. The end of July saw the Bank of Japan decide to alter its yield curve control policy and widen the yield corridor for ten-year bonds. This move came after multiple BoJ interventions in the bond market at the ceiling previously in place.

Forward and survey-based inflation expectations steady

During the period under review, the five-year forward inflation rates five years ahead derived from inflation swaps fluctuated within a narrow corridor around the 1.7% mark (+2 basis points). The long-term survey-based inflation expectations collected by Consensus Economics are still higher than that, at 2.0%. When interpreting this difference, it is necessary to consider potential scarcity, liquidity and inflation risk premiums which can have a bearing on market-based measures and dilute their informative value as economic indicators. Both market-based and survey-based deflation probabilities are negligible for the coming years.

---

1 Bonds issued by the Kreditanstalt für Wiederaufbau (KfW) are explicitly guaranteed by the Federal Republic of Germany. Their default risk is therefore the same as that of German Federal securities, and the yield spread contains premiums for the higher market liquidity of Federal securities. See Deutsche Bundesbank, The market for Federal securities: holder structure and the main drivers of yield movements, Monthly Report, July 2018, pp 15-38.

Yields on corporate bonds up from low level

Yields on European corporate bonds have been picking up slightly since the end of the first quarter from what is still a low level. Bonds issued by BBB-rated enterprises with a residual maturity of between seven and ten years yielded 22 basis points higher at 2.0%. The drop in yields on German Federal securities in the seven to ten-year residual maturity bracket in the same period meant that the yield spread widened still further. One contributing factor here is the somewhat higher level of attention overall which investors have been paying to riskier paper since mid-May. The yield spread of financial corporate bonds over Bunds rose somewhat more sharply than that of non-financial corporate bonds. This might have something to do with the fact that financial corporations were feeling the effects of the yield on safe bonds in the euro area having returned to a somewhat lower level. What is more, the price losses registered above all by Italian sovereign bonds from mid-May onwards spilled over to affect yields for financial corporations. This is normally the case because there are sometimes close financial ties between the state as an issuer and banks as investors. Towards the end of the reporting period, some financial corporations were weighed down by their exposures in Turkey. Meanwhile, more creditworthy corporations rated AA have even seen their yields dwindle slightly since the end of March, while the spreads on high-yield bonds experienced stronger-than-average increases. Compared with their five-year means, however, financing conditions for enterprises are still favourable.

Net redemptions in the German bond market

Gross issuance in the German bond market amounted to €326 billion in the second quarter of 2018, well up on its previous-quarter level (€298½ billion). After deducting redemptions and taking account of changes in issuers' holdings of their own bonds, net redemptions of bonds came to €5 billion. Foreign borrowers placed debt securities worth €3 billion net in the German market, meanwhile. The outstanding volume of debt securities in the German bond market thus fell by €2 billion net in the period under review.

Investment activity in the German securities markets

€ billion

Item	2017 Q2	2018 Q1	2018 Q2
Debt securities			
Residents	28.8	40.6	17.6
Credit institutions	− 13.6	− 1.9	− 11.1
of which			
Foreign debt securities	− 0.4	3.3	− 1.2
Deutsche Bundesbank	38.4	19.1	19.2
Other sectors	4.0	23.3	9.6
of which			
Domestic debt securities	− 13.4	4.5	4.7
Non-residents	1.1	5.1	− 19.6
Shares			
Residents	− 3.5	17.6	23.1
Credit institutions	3.1	− 6.5	0.9
of which			
Domestic shares	5.7	− 3.9	1.3
Non-banks	− 6.6	24.2	22.2
of which			
Domestic shares	− 4.7	1.8	6.1
Non-residents	0.1	4.4	3.6
Mutual fund shares			
Investment in specialised funds	9.3	25.4	12.9
Investment in retail funds	7.6	6.9	4.1
of which			
Equity funds	1.1	0.2	− 1.6

Deutsche Bundesbank

Decline in public sector capital market debt

In the second quarter, the public sector again redeemed bonds, this time amounting to €8 billion net, following €8½ billion in the previous quarter. These figures also include issues by resolution agencies set up for German banks, which are ascribed to the public sector for statistical purposes. The Federal government itself redeemed mainly five-year Federal notes (Bobls), amounting to €23½ billion. This contrasted with net issuance of ten-year and 30-year Bunds totalling €8½ billion and €6 billion, respectively, as well as Treasury discount paper (Bubills) worth €5 billion. The quarter under review saw state and local governments redeem their own bonds to the tune of €1½ billion net.

Net redemptions by credit institutions

Across April, May and June, domestic credit institutions reduced their capital market debt by €4½ billion net, following net issuance of €25 billion in the previous quarter. The decline mainly concerned the outstanding volume of other bank debt securities that can be structured flexibly (€7½ billion) and of public Pfandbriefe (€3½ billion). By contrast, there was net issuance of mortgage Pfandbriefe and debt securities issued by specialised credit institutions, amounting to €3½ billion and €3 billion, respectively.

Increase in enterprises' capital market debt

Domestic enterprises issued debt securities worth €7½ billion net in the second quarter, the bulk of which, on balance, were bonds with maturities of more than one year. Net issuance by non-financial corporations and by insurers (€1 billion and €½ billion, respectively) was lower than issuance by other financial intermediaries (€5 billion).

Purchases of debt securities

The Bundesbank was the main buyer of debt securities in the German bond market in the second quarter, acquiring €19 billion worth of paper, predominantly under the Eurosystem's asset purchase programmes. These were primarily domestic securities issued by the public sector (€16 billion). Domestic non-banks purchased debt securities to the tune of €9½ billion. By contrast, foreign investors and domestic credit institutions offloaded bonds amounting to €19½ billion and €11 billion net, respectively.

Equity market

Global stock markets influenced by overall robust economic backdrop

The overall robust macroeconomic environment and an altogether upbeat corporate profit outlook shaped international equity markets from the end of March. However, price growth was dampened in the euro area especially by the political risks stemming from Italy and Turkey. At +0.6% and -0.5%, respectively, the broad EURO STOXX index and the German CDAX were virtually unchanged from their end-of-March levels. Taken in isolation, the easing risk-free interest rates buoyed up price developments in the euro area. Falling risk-free interest rates depress the discount factor, raising the value of future profits. In addition, profit expectations rose again from their already elevated level. It is possible that the euro's quite considerable depreciation against the US dollar also played a role here since it is serving to boost the sales opportunities of euro area enterprises in the medium term. However, against the backdrop of the political uncertainty referred to above, market participants demanded a higher risk premium. The US S&P 500 racked up notable gains, climbing by 7.6%. With the US economy running smoothly, the quarterly reporting season is shaping up predominantly well there, and market analysts revised their medium-term profit expectations upwards. The indices in Japan (Nikkei 225) and the United Kingdom (FTSE-All Share) rose by 3.4% and 6.6%, respectively.

European automotive and bank shares underperform total market

While the political uncertainties described above had a direct impact on both share prices and measures of volatility, the effects were, for the most part, short-lived. They do, however, remain a source of bother and could well cloud the favourable market environment – especially in those branches which are particularly affected and stand at the centre of the trade dispute. European automotive stocks have recorded significant losses since the end of March, for instance.

The same is true for bank shares which – on both sides of the Atlantic – underperformed the total index for the respective region. While US bank stocks posted flatter gains of 4.5%, shares in euro area banks fell significantly in value even in absolute terms, losing 15.7%. The latter managed to recoup only a small portion of the fall in prices triggered at the end of May by the uncertainty in Italy. Some banks also saw their share prices take a hit from their exposure to Turkey. The yield curve, now flatter again than it was at the end of March, was another factor weighing on banks' earnings prospects in the euro area.

The EURO STOXX earnings yield, calculated on the basis of earnings forecasts for the next 12

Implied cost of equity unchanged in the euro area, falling in the USA

months (the inverse price/earnings ratio) fell against the end of March, indicating a higher valuation than at the end of the first quarter. By contrast, the implied cost of equity – which is derived using a dividend discount model from the sum of the risk-free interest rate and the equity risk premium – remains virtually unchanged.[2] The equity risk premium compensates investors for holding risky equities instead of safe Federal securities. Taken in isolation, the risk premium remained well above its multi-year average. This is a reflection of the fact that the risk-free interest rate and the risk premium normally move in opposite directions, offsetting each other's effect on the cost of equity. In the United States, share prices rose so sharply that despite improved business outlooks, the earnings yield and implied cost of equity fell. The risk premium relative to US Treasuries shrank during the period under review.

Stock market funding and stock purchases

Issuance in the German equity market was somewhat brisker in the second quarter than it had been in the three months before that. Domestic enterprises issued €11 billion worth of new shares. This was largely attributable to a capital increase carried out by one DAX-listed enterprise. The outstanding volume of foreign shares in the German market rose by €15½ billion over the same period. Equities were purchased primarily by domestic non-banks (€22 billion) and foreign investors (€3½ billion), but also – to a lesser extent – by domestic credit institutions (€1 billion).

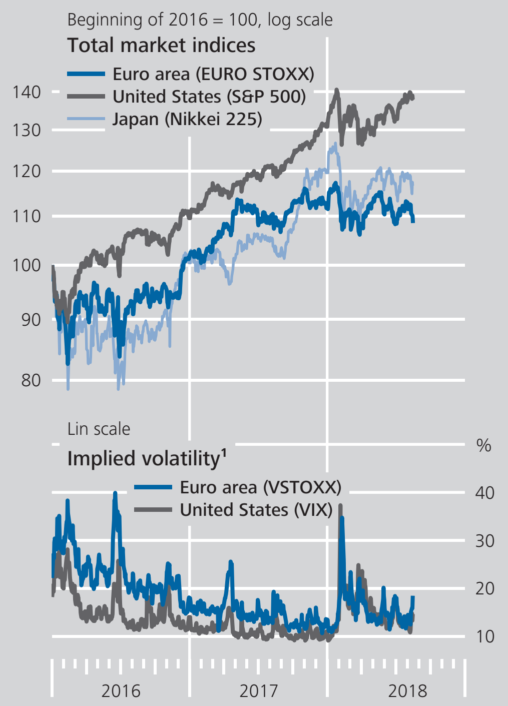
Sales and purchases of mutual fund shares

During the quarter under review, domestic investment companies recorded inflows of €17 billion, after raising funds totalling €32½ billion in the previous three-month period. The fresh money mainly accrued to specialised funds reserved for institutional investors (€13 billion). Among the various asset classes, mixed securities-based funds attracted the strongest inflows (€9½ billion), but bond funds (€3 bil-

2 See Deutsche Bundesbank, Stock market valuations – theoretical basics and enhancing the metrics, Monthly Report, April 2016, pp 15-29.

Equity market

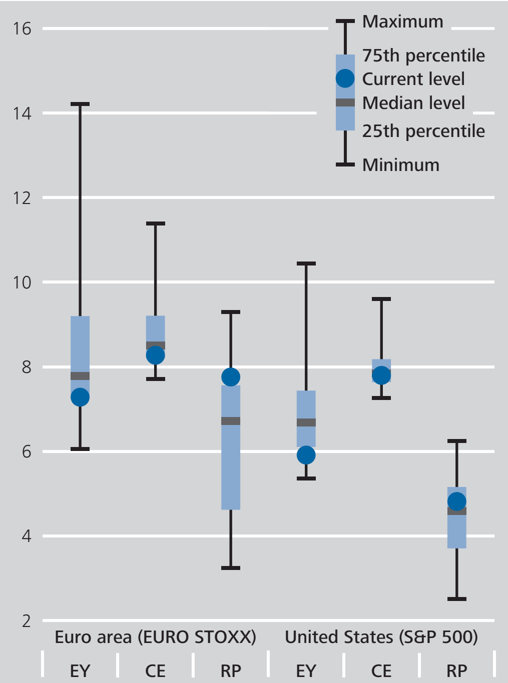
Daily data



Sources: Thomson Reuters and Bundesbank calculations. 1 Calculated from the prices of index options. For the euro area, calculated from options on the EURO STOXX 50.
Deutsche Bundesbank

Stock market valuations

% pa, data since January 2004



Sources: Thomson Reuters I/B/E/S, Bundesbank calculations. Earnings yields (EY) plotted as an inverted price/earnings ratio; implied cost of equity (CE) and equity risk premium (RP) derived from the dividend discount model.
Deutsche Bundesbank

Major items of the balance of payments

€ billion

Item	2017 Q2	2018 Q1	2018 Q2p
I Current account	+ 53.6	+ 71.1	+ 63.0
1 Goods[1]	+ 67.1	+ 64.6	+ 68.2
2 Services[2]	− 4.8	− 0.6	− 3.3
3 Primary income	+ 3.1	+ 21.6	+ 3.5
4 Secondary income	− 11.8	− 14.5	− 5.4
II Capital account	− 0.7	+ 0.2	+ 0.1
III Financial account (increase: +)	+ 72.1	+ 74.6	+ 64.4
1 Direct investment	+ 12.5	+ 22.0	+ 30.6
Domestic investment abroad	+ 19.3	+ 42.6	+ 55.1
Foreign investment in the reporting country	+ 6.8	+ 20.5	+ 24.5
2 Portfolio investment	+ 20.2	+ 34.8	+ 25.1
Domestic investment in foreign securities	+ 20.0	+ 42.4	+ 6.3
Shares[3]	− 2.4	+ 8.2	− 1.6
Investment fund shares[4]	+ 4.7	+ 8.6	+ 4.7
of which Money market fund shares	− 5.3	− 1.1	− 0.0
Long-term debt securities[5]	+ 19.2	+ 25.2	+ 4.3
of which Denominated in euro[6]	+ 13.3	+ 23.9	+ 5.8
Short-term debt securities[7]	− 1.5	+ 0.5	− 1.1
Foreign investment in domestic securities	− 0.1	+ 7.6	− 18.8
Shares[3]	+ 0.1	+ 4.3	+ 3.6
Investment fund shares	− 1.3	− 1.8	− 2.9
Long-term debt securities[5]	+ 3.1	+ 16.6	− 20.4
of which Issued by the public sector[8]	− 2.2	− 2.3	− 21.6
Short-term debt securities[7]	− 2.0	− 11.5	+ 0.9
3 Financial derivatives[9]	+ 2.6	+ 1.2	+ 9.6
4 Other investment[10]	+ 36.4	+ 15.9	− 0.5
Monetary financial institutions[11]	− 7.6	− 4.0	− 13.2
Enterprises and households[12]	+ 14.6	+ 16.1	− 11.3
General government	− 1.1	− 0.1	− 4.2
Bundesbank	+ 30.4	+ 4.0	+ 28.2
5 Reserve assets	+ 0.4	+ 0.7	− 0.4
IV Errors and omissions[13]	+ 19.2	+ 3.3	+ 1.3

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** 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.

Deutsche Bundesbank

lion) also sold new shares, as did funds of funds and open-end real estate funds (€2½ billion in each case). Foreign funds operating in the German market attracted fresh funds totalling €4½ billion net in the second quarter of 2018. Domestic non-banks were the main buyers, adding mutual fund shares worth €23 billion to their portfolios, predominantly in the form of domestic fund units. German credit institutions purchased investment fund shares for €1½ billion, while foreign investors sold mutual fund shares worth €3 billion.

Direct investment

Direct investment sees capital exports

As with cross-border portfolio investment, which saw net outflows totalling €25 billion in the second quarter of 2018, there were also net capital exports in the field of direct investment, amounting to €30½ billion.

German foreign direct investment

Direct investment abroad by German enterprises came to €55 billion net in the April-June 2018 period. Domestic investors boosted their equity capital by €58 billion, with a clear emphasis on investment in equity capital in the narrower sense; foreign earnings were also reinvested as well, however. By contrast, German enterprises scaled back intra-group lending by €2½ billion in the period under review. Major euro area destinations for German foreign direct investment in the second quarter of 2018 were the Netherlands (€30 billion), Spain (€16 billion) and Ireland (€5 billion), while outside of the euro area the United States was a key recipient (€2½ billion).

Foreign direct investment in Germany

Foreign investors stepped up their direct investment in Germany by €24½ billion on balance in the second quarter, primarily in the shape of loans to affiliated enterprises in Germany, supplied particularly by way of "reverse flows" – vehicles which foreign subsidiaries use to forward funds raised in the international financial market to their parent companies as loans. By contrast, intra-group trade credits were mainly redeemed. Foreign investors increased their equity stakes in domestic enterprises only slightly (€1 billion), mainly using reinvested earnings to do so. In regional terms, investors from the euro area, particularly from the Netherlands (€20½ billion) and Belgium (€5 billion), played a major role.