Financial markets

Financial market setting

Yields up amid persistent core inflation and monetary policy tightening

The inflation outlook also shaped events in financial markets. Price pressures turned out to be unexpectedly persistent, mainly for the less volatile core components of consumer prices. Labour markets, which are important for the pace at which inflation declines, likewise proved robust. This is the background against which central banks in most major currency areas decided on further policy rate increases and made it clear that the degree of monetary policy restriction would continue to increase. Only towards the end of the period under review did expectations emerge – especially for the United States – that the end of the rate hike cycle might be reached in the near future. Risk-free yields in bond markets rose on balance over the reporting period.

Sentiment in the markets for risky asset classes was upbeat overall, as reflected in a robust appetite for risk, which was also buoyed by the continued decline in uncertainty surrounding the US regional banking sector. This led to a drop in the yield spreads on less liquid bonds, corporate bonds and some other government bonds, including in the euro area. The ECB Governing Council's decision not to reinvest the principal payments from maturing securities under the asset purchase programme (APP) as of July 2023 also did not prompt any reassessment of the differences in credit quality across European government bonds.

Diverging economic outlook leads to mixed developments in global equity markets

In equity markets, investors' persistently strong appetite for risk combined with a more robust US economy provided a significant boost for the US S&P 500 index; in Europe, by contrast, the gloomier economic outlook for the euro area meant that the EURO STOXX index posted minor losses. Overall, the monetary policy measures taken are passing through to financing conditions in the euro area capital market roughly as strongly as past experience would suggest. Market participants' assessments of underlying price pressures in the different currency areas, and thus their view of future central bank policy, provided key impetus for foreign exchange markets as well. In this context, the euro appreciated for a time against the US dollar, but was unable to hold onto its gains, with the result that the exchange rate remained almost unchanged on balance.

Exchange rates

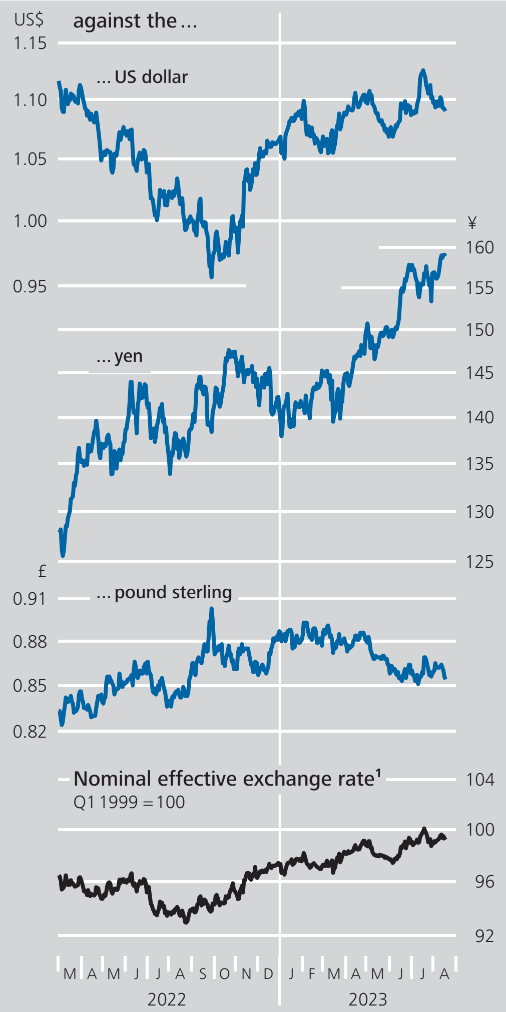
Euro practically unchanged against US dollar, …

On balance, the exchange rate of the euro against the US dollar remained virtually unchanged compared with the start of the second quarter of 2023. However, the euro did come under pressure initially over the course of May, partly off the back of a series of economic figures that were unexpectedly strong for the United States but weaker for the euro area. These figures showed the US economy to be more dynamic than that of the euro area, which buoyed the US dollar. They also reinforced the impression held by market participants that the Federal Reserve would continue to raise its policy rate beyond the summer. As this caused the yield spread between the United States and the euro area to widen, investors increasingly sought US dollar-denominated assets, thus weakening the euro.

From June onwards, sentiment in the foreign exchange markets swung in the other direction. The publication of US inflation figures in June and July, in particular, added to the signs of an easing of price pressures in the United States and fuelled market participants' expectations that a further Fed interest rate hike in July might in fact be the last one for the time being. At the same time, interest rate expectations for the euro area continued to rise. There were also indications that an economic downturn in the United States might not be necessary to effectively push down inflation to-

Exchange rate of the euro

Daily data, log scale



Sources: ECB and Bundesbank calculations. **1** Calculated against the currencies of 18 countries. A rise in values indicates an appreciation of the euro.
Deutsche Bundesbank

ward the target. In the foreign exchange market, this led to a marked improvement in sentiment and an increase in the global appetite for risk. This combination of interest rate expectations and increasing risk appetite led to net capital outflows from the United States, which weakened the external value of the US dollar against the euro. The latter appreciated to US$1.13, reaching its highest level since February 2022. However, the euro gave up part of its gains as the impression took hold that there might be no further policy rate hikes in the euro area either, at least for the time being. At the end of the reporting period, the euro was trading at US$1.09, up 0.2% on its value at the end of March.

... up markedly against the yen, ...

The euro was markedly stronger against the yen. The main reason for the sustained depreciation of the yen against a variety of currencies is the Bank of Japan's monetary policy. The Bank of Japan remained committed to negative interest rates despite continued price pressures and the rising policy rates of other major central banks. This initially further widened the gap to euro area yields, which were also on the up, and weakened the yen against the euro. In July, the appreciation of the euro came to an end amid emerging speculation that the Bank of Japan might soon ease its yield curve control. The actual decision to control the band more flexibly at the end of the month did not provide the yen with any additional sustained support (see also the section on capital markets on p. 44). Overall, the euro recorded a marked gain of 9.7% compared to the end of March and was trading at ¥159 at the end of the reporting period.

... but down against the pound sterling

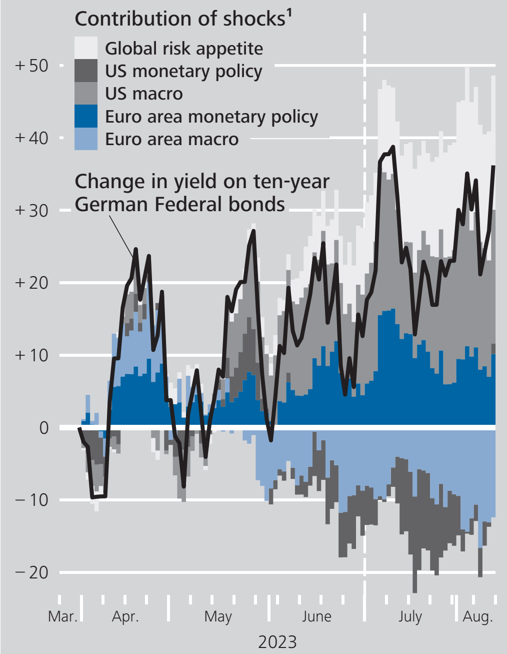
The euro depreciated against the pound sterling. As against the US dollar, the euro progressively lost value against the pound sterling over the course of May in the wake of some weak economic data for the euro area. While the United Kingdom has itself been facing weak economic growth and stubbornly high inflation for some time, observers increasingly assumed that the persistently high price pressures would force the Bank of England to raise its policy rate above the level in other advanced economies. Yields thus rose noticeably more strongly than in the euro area, strengthening the pound into the summer months. Only in July, with the announcement of lower than expected inflation figures for the United Kingdom, did expectations of further interest rate hikes by the Bank of England decline and the euro appreciate slightly again for a while. At the end of the period under review, the euro stood at £0.85, which was 2.9% lower than at the end of the first quarter.

In effective terms, euro stronger on balance

On a weighted average against the currencies of 18 major trading partners, the euro appreciated by 1.1% on balance. This was mainly due to the euro's gains against the yen and the renminbi (6.2%). Measured against a broad group of 41 currencies, the appreciation of the effective euro was higher still at 2.7%. However, this development is mainly due to the sharp depreciation of just a few currencies. The appreciation of the euro against the Turkish lira (41.6%) and the Russian rouble (25.5%) stand out here in particular. The effective euro thus reached a record high against the broad group of partner currencies at the end of July. It should be noted, however, that the external value of the euro against currencies with a similar stability-oriented monetary policy to that of the Eurosystem is a long way off its previous highs.

Historical decomposition of ten-year German Federal bonds

Cumulated change since 31 March 2023 in basis points, daily data



Sources: Refinitiv and Bundesbank calculations. **1** Based on a VAR model with sign restrictions (see Brandt et al., 2021). Estimation period: January 1999 to August 2023.
Deutsche Bundesbank

Securities markets and portfolio transactions

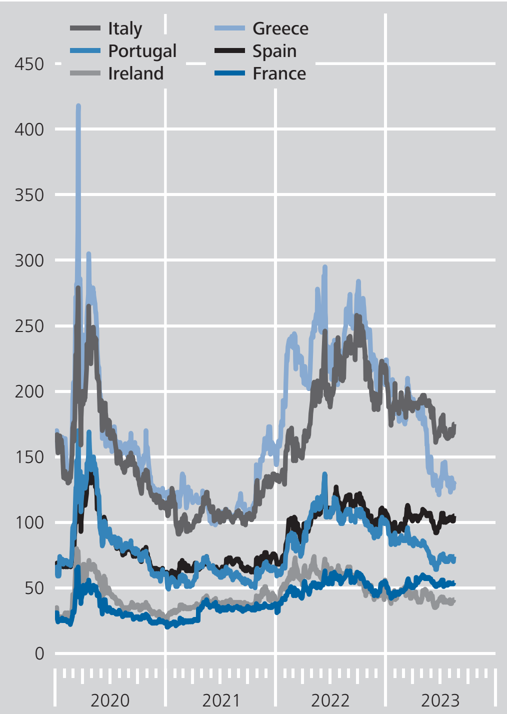
Bond market

Yields on ten-year government bonds up in euro area and United States

Nominal government bond yields increased from their levels at the end of the first quarter of 2023, above all in the United States, but also to a more moderate extent in the euro area. In this context, the main focus of attention in government bond markets was the persistence of inflation dynamics and the question of how restrictive the path of monetary policy tightening measures needs to be in order to achieve a timely return to the 2% stability mark. The Federal Reserve raised its key interest rate twice in the reporting period, each time by 25 basis points. At the beginning of the reporting period, expectations of further policy rate hikes were initially dampened by concerns that further problems in the US regional banking sector could weigh more heavily on the economy. However, these uncertainties gradually dissipated over the remainder of the period. The US policy rate path expected by market participants therefore shifted further upwards in light of the robust US economy and unexpectedly persistent inflation, even though market participants latterly considered the likelihood of a further interest rate move in the near future to be rather low. Increased policy rate expectations contributed to higher US government bond yields at the long end of the yield curve as well. Higher term premia additionally increased upward pressure on the yields of long-term US Treasuries. The decision by rating agency Fitch to downgrade the US credit rating by one notch from “AAA” to “AA+” did not significantly affect the yields on ten-year US Treasuries, which increased over the entire reporting period by 82 basis points to 4.3%. The Eurosystem also continued to tighten its monetary policy stance, raising key interest rates by a total of 75 basis points in three steps since the end of the first quarter. While inflationary pressures remained high, the economic picture in the euro area deteriorated, though this did not, in itself, significantly dampen the rise in yields. On balance, the GDP-weighted yield on ten-year euro area bonds increased by 40 basis points to 3.3%.

Spreads of ten-year government bonds over German Federal bonds

Basis points, daily data



Sources: Bloomberg and Bundesbank calculations.
Deutsche Bundesbank

Higher yields on ten-year German Federal securities

Yields on ten-year Federal bonds (Bunds) rose to a similar extent (+42 basis points to 2.7%) amid minor fluctuations. A model decomposition of the yield curve of Federal securities into an expected policy rate path and term premia shows that this increase in yields is attributable first and foremost to higher nominal term premia. The latter also include inflation risk premia, which compensate for the risk of inflation being unexpectedly high. Of late, market participants have demanded a higher premium for this inflation risk, in particular (see the section on the inflation risk premium on p. 45).

Yield curve of Federal securities becomes more inverted

The Federal securities yield curve shifted upwards during the period under review. As a result of the Eurosystem's (expected) policy rate hikes, yields rose at the short end, in particular. As short-term yields rose more strongly than long-term yields, the yield curve inverted further. A strongly inverted yield curve is empirically regarded as a signal that market participants expect a recession over the next 12 months. The model-implied probability of an impending recession, as estimated from the slope of the yield curve, thus rose significantly.[1]

Yields up in United Kingdom and Japan

In the United Kingdom, the yields on ten-year gilts rose markedly in the period under review (+128 basis points to 4.8%). As the UK inflation outlook remained high, the Bank of England raised its key interest rate by a total of 100 basis points in the period under review. In Japan, too, yields rose as a result of monetary policy decisions. In July, the Bank of Japan decided to conduct its yield curve control policy with greater flexibility. While its target is still to keep long-term interest rates close to 0%, it raised the strict ceiling of the target range at which it may purchase unlimited amounts of government bonds by 50 basis points to 1%. Against this backdrop, the yield on ten-year Japanese government bonds rose relatively significantly to 0.7% (+33 basis points), which also pushed up global yields for a time. Yields on Japanese bonds were thus at a level last observed in 2014.

Yield spreads in the euro area virtually unchanged

As this report went to press, ten-year German Federal bonds were yielding 0.9 percentage point lower than the maturity-matched government bonds of other euro area countries (GDP-weighted average). The yield spread therefore barely changed on balance and remained close to the five-year average (0.8 percentage point). The fact that reinvestments of maturing securities under the APP were discontinued in July 2023 therefore did not provide any visible boost to yield spreads. Greek bond spreads fell very sharply (-64 basis points), which is probably partly attributable to the re-election of the Greek government in June. The government vowed to repay ahead of schedule bilateral as-

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1 On the basis of different model approaches and taking into account the term spread between ten-year and three-month government bond yields, there is currently a historically high market-based probability of a recession. In the model approach, earlier recessions are dated according to the definition used by the German Council of Economic Experts. For a discussion of the model approach, see Deutsche Bundesbank (2023).

sistance loans issued by euro area countries during the sovereign debt crisis.

Market participants expected inflation rates to remain high in the short to medium term

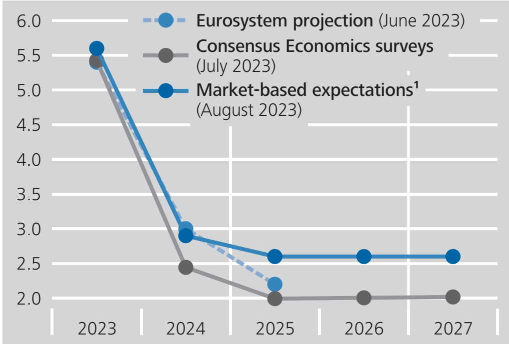
Market-based inflation expectations for the euro area remained well above the 2% definition of price stability across the entire ten-year observation period. Market-based inflation expectations for 2023 declined as inflation figures edged down slowly. Despite this, forward inflation rates extending beyond the current year did not move closer to the inflation target in a sustainable manner. For instance, towards the end of the period under review, market participants expected inflation rates of 2.9% and 2.6% for 2024 and 2025, respectively, meaning that market-based inflation measures were also above the definition of price stability in the medium term. By contrast, the June Eurosystem staff macroeconomic projections assumed a baseline scenario for the inflation outlook, according to which inflation will reach a level of 2.2% in 2025. Although the inverted yield curve indicated that market participants expected an economic slowdown, they therefore also anticipate inflation rates to be too high in the medium term. Survey-based inflation expectations calculated by Consensus Economics in July put inflation rates at 5.4%, 2.4% and 2.0% for the years 2023, 2024 and 2025, displaying a pattern that was more compatible with achieving the inflation target by 2025. However, from the perspective of market participants, there was a high risk that this target would be missed.

Long-term inflation expectations up

Longer-term market-based inflation expectations remained worryingly high and continued to rise. The five-year forward inflation rate five years ahead, which is derived from inflation swaps, stood at 2.6% at last count, up 20 basis points from the end of the first quarter. It thus exceeded the level observed at the beginning of March this year, which until then had been the highest figure recorded since 2012. Meanwhile, quarterly survey-based inflation expectations calculated by Consensus Economics for the euro area six to ten years ahead remained virtually unchanged. They were therefore still close to the inflation target of 2% in July, too. Consequently, the difference between market-based and survey-based long-term inflation expectations widened. This difference is considered primarily as a measure of the inflation risk premium. Its increase reflected market participants' growing concern that inflation could be above the inflation target in the medium and long term. The probabilities of future inflation rates derived from inflation options also pointed to a high degree of uncertainty among market participants. An average inflation rate of above 2% over the next five years was implicitly considered by far the most likely scenario.

Expectations for HICP inflation in the euro area

Year-on-year percentage change



Sources: Bloomberg, Consensus Economics, Fenics Market Data and Bundesbank calculations. **1** Forward inflation rates based on inflation-linked swaps (2025 to 2027) and inflation-fixing swaps (2023, 2024).
Deutsche Bundesbank

Long-term inflation expectations in the United States up; survey data down slightly

Market-based five-year US forward inflation rates five years ahead rose to 2.7% (+10 basis points). Meanwhile, quarterly survey-based inflation expectations six to ten years ahead calculated by Consensus Economics fell 11 basis points between April and July to 2.2%. The inflation risk premium as the difference between market-based and survey-based inflation expectations therefore also increased in the United States in the period under review.

Corporate bond yields slightly higher

Yields on BBB-rated European corporate bonds and high-yield bonds with residual maturities of between seven and ten years rose slightly. Within the BBB rating category, bond yields of financial corporations fell by 13 basis points,

Long-term forward inflation rates* in the euro area and the United States

% p.a., weekly averages

Sources: Bloomberg, Refinitiv, 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.
Deutsche Bundesbank

whereas those of non-financial corporations increased (+29 basis points). The decline in financial corporate bond yields was in line with tensions easing markedly in the European banking sector. This was also reflected in visibly declining credit default premia on subordinated bonds issued by financial corporations (as measured by the iTraxx Europe Subordinated Financials index) and in European credit institutions' equity price gains (see p. 47). Yield spreads over Bunds with the same maturity narrowed markedly in both the BBB and high-yield segments. Thus, significantly higher risk-free interest rates did not translate into tighter financing conditions for corporate bonds. Nevertheless, measured by yield spreads, financing costs for European enterprises in all rating categories remained significantly above their respective five-year averages.

High net issuance of German debt securities

At €465½ billion, gross issuance in the German bond market in the second quarter of 2023 was down somewhat on the previous quarter's figure (€473½ billion). Net of redemptions and changes in issuers' holdings of their own debt securities, domestic issuers ramped up their capital market borrowing by €52½ billion. The outstanding volume of foreign debt securities in the German market rose by €48 billion in the second quarter. On balance, the total outstanding volume of bonds in Germany thus climbed by €100½ billion in the quarter under review.

Net public sector issuance

In the second quarter of 2023, the public sector issued bonds to the tune of €26½ billion net, following €30 billion in the previous three-month period. The Federal Government (including the resolution agency classified as part of central government) issued mainly 7-year and 30-year Federal bonds (Bunds) (€10 billion and €14½ billion, respectively) as well as Treasury discount paper (Bubills) (€10½ billion). Meanwhile, net redemptions of ten-year Bunds totalled €5½ billion. State and local governments redeemed debt securities worth €7 billion on balance.

Rise in credit institutions' capital market debt

The quarter under review saw domestic credit institutions increase their capital market debt by €21 billion, compared to €47½ billion in the previous quarter. The primary instruments used were debt securities issued by specialised credit institutions as well as other bank debt securities that can be structured flexibly (€8½ billion and €7 billion, respectively), but also mortgage Pfandbriefe and public Pfandbriefe on a smaller scale (€4 billion and €1 billion, respectively).

Net issuance of corporate bonds

Domestic enterprises issued bonds worth €5 billion net in the second quarter, following €1 billion in the previous three-month period. On balance, the primary issuers here were non-financial corporations (€2½ billion). However, other financial intermediaries and insurance corporations also issued new bonds worth €1½ billion net in each case.

Purchases of debt securities

In the second quarter of 2023, domestic non-banks expanded their bond portfolios in the bond market by €69 billion net, striking a more or less even balance between domestic and foreign securities. Non-resident investors expanded their German bond portfolio by €38½ billion net. Domestic credit institutions purchased bonds worth €17 billion net, which consisted almost exclusively of foreign securities. The Bundesbank's holdings of debt securities fell by €24 billion on balance. This was largely because securities from the Eurosystem's purchase programmes matured and principal payments were only partially reinvested up until July and have not been reinvested since.

Equity market

International equity markets supported by robust US economy and investors' risk appetite

The international equity markets were characterised by diverging economic signals on either side of the Atlantic and an increase in global risk appetite. In the United States, investor optimism was mainly boosted by favourable macro data – in particular the surprisingly strong economic growth recorded in the second quarter and continued positive signals from the US labour market. Together with the signs of easing US price pressures, this fuelled the hope that the Federal Reserve would be able to successfully lower inflation without having to accept a sharp economic downturn. This outlook was further strengthened by the fact that the previous tensions in the US regional banking system continued to ease and, most recently, no longer played a significant role in financial market developments. Concerns stemming from the first quarter that the tensions in the US regional banking sector could make it more difficult for the Fed to combat inflation therefore also waned. The growth in investor confidence provided a particularly strong boost to shares in technology companies, which investors primarily see as having favourable long-term prospects. It was also reflected in a sharp decline in uncertainty about future developments in US equity prices, which can be measured by the implied volatility of broad equity indices.

Investment activity in the German securities markets

€ billion

	2022	2023	
Item	Q2	Q1	Q2
Debt securities			
Residents	35.5	85.4	62.3
Credit institutions	− 3.0	32.1	17.2
of which:			
Foreign debt securities	6.8	27.9	16.3
Deutsche Bundesbank	25.2	1.1	− 23.8
Other sectors	13.3	52.2	68.8
of which:			
Domestic debt securities	26.3	15.2	35.8
Non-residents	− 6.2	57.1	38.4
Shares			
Residents	− 10.5	14.9	4.7
Credit institutions	− 1.2	9.4	− 2.6
of which:			
Domestic shares	− 0.2	− 0.8	0.5
Non-banks	− 9.2	5.4	7.3
of which:			
Domestic shares	11.3	9.8	8.5
Non-residents	− 8.6	− 4.8	− 4.8
Mutual fund shares			
Investment in specialised funds	15.6	14.9	4.0
Investment in retail funds	3.3	5.8	1.2
of which:			
Equity funds	3.4	4.8	0.8

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European equity markets down slightly, strong growth in the United States and Japan

Taken in isolation, the surprisingly positive US economic signals and the increase in global risk appetite also boosted European equities. In the euro area, however, these price-supporting factors were partly offset by higher risk-free interest rates as well as, first and foremost, the distinct deterioration in the economic outlook since the end of April which slowed the upward movement in the equity markets. As in the previous quarter, market participants' focus was also on the future monetary policy stance. However, speculation that the economic slowdown could cause the Eurosystem to soften its anti-inflationary stance ultimately had only a temporary impact on equity prices. On balance, the prices of European equities (EURO STOXX), German equities (CDAX) and UK shares (FTSE 100) have fallen slightly since the end of the first quarter (-2.2%, -2.9% and -4.2%, respectively). Meanwhile, US equities (S&P 500), which are relatively heavily influenced by technology companies, recorded an increase of

Major items of the balance of payments

€ billion

Item	2022 Q2	2023 Q1	2023 Q2p
I. Current account	+ 30.5	+ 69.9	+ 60.1
1. Goods	+ 27.0	+ 55.2	+ 56.4
2. Services	− 5.3	− 6.7	− 14.4
3. Primary income	+ 22.3	+ 41.1	+ 27.5
4. Secondary income	− 13.5	− 19.6	− 9.3
II. Capital account	− 4.8	− 11.3	− 4.0
III. Financial account (increase: +)	+ 67.3	+ 100.4	+ 60.5
1. Direct investment	+ 53.0	+ 38.1	+ 11.5
Domestic investment abroad	+ 59.2	+ 27.9	+ 25.2
Foreign investment in the reporting country	+ 6.2	− 10.2	+ 13.7
2. Portfolio investment	+ 12.8	+ 25.7	+ 15.8
Domestic investment in foreign securities	+ 1.6	+ 78.9	+ 48.1
Shares[1]	+ 3.2	+ 4.1	− 4.7
Investment fund shares[2]	+ 3.6	+ 10.9	+ 4.7
of which: Money market fund shares	+ 1.5	+ 0.5	+ 1.7
Short-term debt securities[3]	+ 0.3	+ 7.6	+ 2.9
Long-term debt securities[4]	− 5.5	+ 56.3	+ 45.1
of which: Denominated in euro[5]	− 1.1	+ 55.9	+ 34.4
Foreign investment in domestic securities	− 11.1	+ 53.2	+ 32.3
Shares[1]	− 5.9	− 4.9	− 5.1
Investment fund shares	+ 1.0	+ 0.9	− 1.0
Short-term debt securities[3]	− 2.7	+ 1.6	+ 9.5
Long-term debt securities[4]	− 3.6	+ 55.6	+ 28.9
of which: Issued by the public sector[6]	− 2.8	+ 47.5	+ 23.7
3. Financial derivatives[7]	+ 12.9	+ 20.2	+ 11.2
4. Other investment[8]	− 11.9	+ 16.1	+ 20.9
Monetary financial institutions[9]	− 25.5	− 42.6	+ 10.8
Enterprises and households[10]	− 7.2	+ 28.6	+ 37.8
General government	− 10.5	+ 8.4	− 2.8
Bundesbank	+ 31.3	+ 21.7	− 24.9
5. Reserve assets	+ 0.6	+ 0.2	+ 1.1
IV. Errors and omissions[11]	+ 41.6	+ 41.8	+ 4.5

1 Including participation certificates. **2** Including reinvested earnings. **3** Short-term: original maturity of up to one year. **4** Long-term: original maturity of more than one year or unlimited. **5** Including outstanding foreign Deutsche Mark bonds. **6** Including bonds issued by the former Federal Railways, the former Federal Post Office and the former Treuhand agency. **7** Balance of transactions arising from options and financial futures contracts as well as employee stock options. **8** Includes, in particular, loans and trade credits as well as currency and deposits. **9** Excluding the Bundesbank. **10** Includes the following sectors: financial corporations (excluding monetary financial institutions) as well as non-financial corporations, households and non-profit institutions serving households. **11** 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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6.4%. Japanese equities (Nikkei index) appreciated by as much as 12.8%.

Bank stocks outperform market as a whole

European and US bank stocks continued their recovery in the reporting period, almost recouping the losses they sustained following the turmoil in the US regional banking system in March. Unexpectedly good quarterly results and higher interest margins at big banks on both sides of the Atlantic are likely to have played a major role in the price gains. On balance, the prices of European and US bank stocks rose by 8.1% and 5.6%, respectively, as compared with the end of the first quarter.

Valuations slightly up on both sides of the Atlantic

European and US equity valuations increased somewhat compared with the end of the first quarter. These valuation measures are derived from a dividend discount model that also takes into account enterprises' medium-term earnings outlook and the path of risk-free interest rates. Accordingly, both the equity risk premium and the cost of equity for the EURO STOXX and S&P 500 fell slightly. However, the medium-term earnings outlook moved in different directions for US and European enterprises, respectively. Analysts revised the medium-term earnings outlook downwards for European enterprises in view of the weakened economic outlook, which had a significant dampening effect on share price developments. Meanwhile, the earnings outlook for listed companies in the United States improved considerably. In long-term comparisons, both the equity risk premia and the implied cost of equity currently suggest a relatively high valuation for European and US equities.

Equity market funding

German stock corporations raised €4 billion in new funds on balance in the second quarter of 2023 (previous quarter: also €4 billion). The volume of foreign shares in the German market shrank by €4½ billion in the same period. On balance, domestic non-banks were the sole buyers of equities (€7½ billion). By contrast, foreign investors and domestic credit institutions pared back their equity portfolios by €5 billion and €2½ billion net, respectively.

Sales and purchases of mutual fund shares

During the reporting quarter, domestic investment companies recorded weak inflows of €5 billion, after raising €21 billion in the previous quarter. On balance, specialised funds reserved for institutional investors were by far the greatest beneficiaries (€4 billion). Of the various asset classes, bond funds and open-end real estate funds, in particular, registered significant inflows of capital (€3½ billion and €2 billion, respectively). By contrast, mixed securities funds redeemed their own units to the tune of €1 billion net. The outstanding volume of foreign mutual fund shares in Germany rose by €4½ billion in the period under review. Mutual fund shares were bought on balance almost exclusively by domestic non-banks, which added fund shares worth €11 billion net to their portfolios. Most of these shares were issued by domestic mutual funds. Non-resident investors trimmed their share portfolios in Germany by €1 billion net.

Direct investment

Direct investment sees net capital exports

Against the backdrop of persistently high inflation and a decline in the uncertainty that had temporarily built up in the financial markets as a result of the US banking crisis, transactions in cross-border portfolio investment led to net capital exports of €16 billion in the second quarter of 2023. Direct investment, too, resulted in capital outflows (€11½ billion).

German direct investment abroad results in capital exports

Enterprises domiciled in Germany expanded their direct investment abroad by €25 billion on balance between April and June 2023, compared with €28 billion in the previous three months, primarily providing foreign affiliates with additional equity capital (€25 billion). Reinvested earnings accounted for around two-thirds of this development. Enterprises resident in Germany also granted a small volume of additional credit to affiliated group entities abroad (€½ billion). This was done exclusively through financial loans on balance. By contrast, trade credits were mainly redeemed. Significant volumes of German direct investment flowed to China (€6½ billion), Luxembourg and Switzerland (both countries saw inflows of €4½ billion). By contrast, German enterprises scaled back their direct investment in Ireland, the Netherlands and Finland (€1 billion in each case).

Foreign direct investment in Germany produces capital inflows

Foreign enterprises increased their direct investment in Germany by €13½ billion in the second quarter (following a reduction of €10 billion in the previous quarter) and augmented their equity capital in German subsidiaries by €5½ billion. In addition, they raised the volume of loans granted to German enterprises by €8½ billion, mainly via financial loans. Enterprises from Luxembourg (€8 billion) and the United States (€5 billion) boosted their direct investment funds in Germany by particularly large amounts. By contrast, outflows of direct investment were recorded from Malta, Slovakia and the United Kingdom (€1 billion in each case).

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