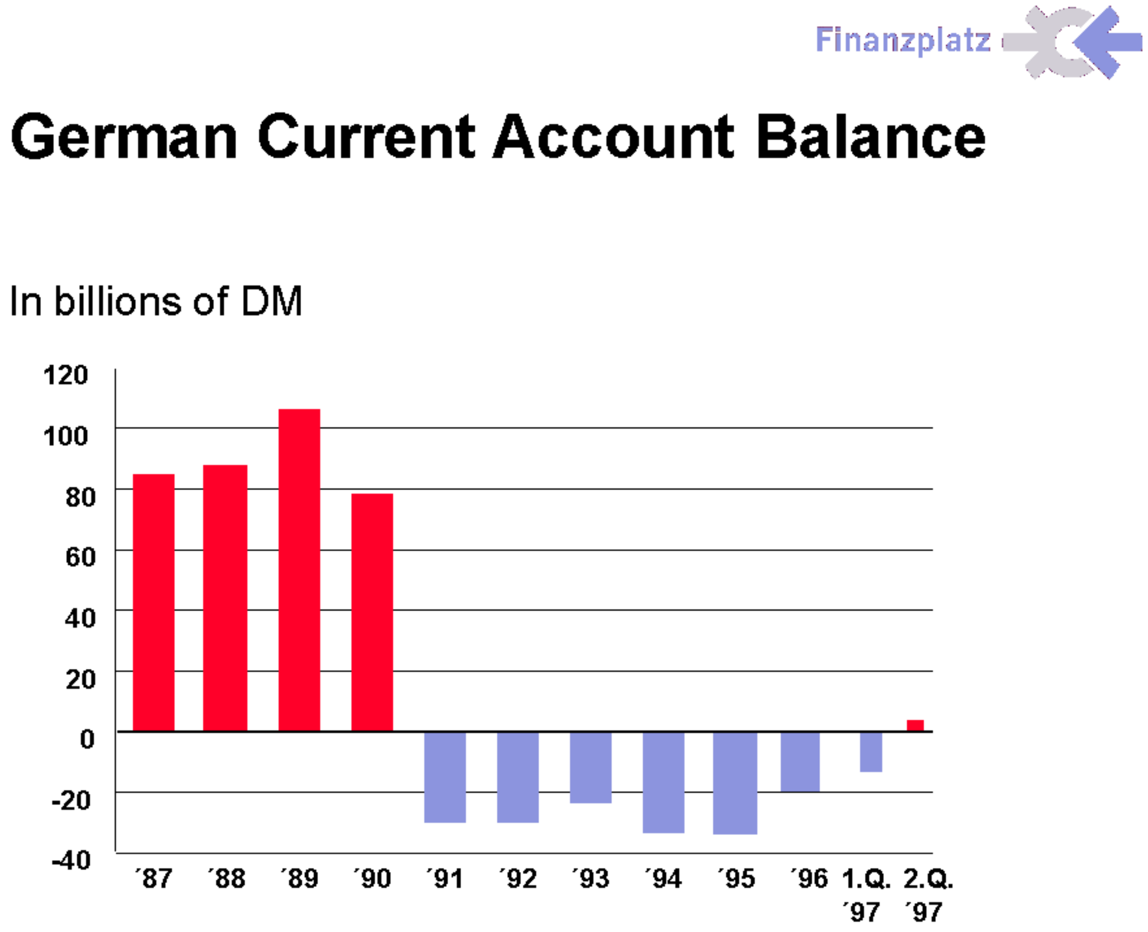
Mr. Gaddum discusses Germany as a financial centre and the strengths of the German capital market of today Speech by the Vice-President of the Deutsche Bundesbank, Mr. Johann Wilhelm Gaddum, at the Financial Centre Roadshow in New York on 14/10/97.

1. Strengths of the German capital market of today

Finanzplatz Deutschland -- the financial centre Germany, which is the "home port" of the D-Mark -- is characterised by the long-standing stability culture of the Deutsche Bundesbank. And the financial centre Germany has benefited considerably from the currency's stability. With the introduction of the euro everything will change. The financial centre Germany will lose its D-Mark bonus. However, it will gain the opportunity to display its competitiveness with the euro in a larger market. The banks, the German parliament and the Bundesbank have been working for years to increase the attractiveness of Germany as a financial centre. With a view to the introduction of the euro, it is important to further strengthen the competitiveness reached so far through additional innovations. It is essential to prepare for competition in the large European market. But we can say with some satisfaction that even today the financial centre Germany, which is the biggest and most dynamic financial market in continental Europe, is in a good position.

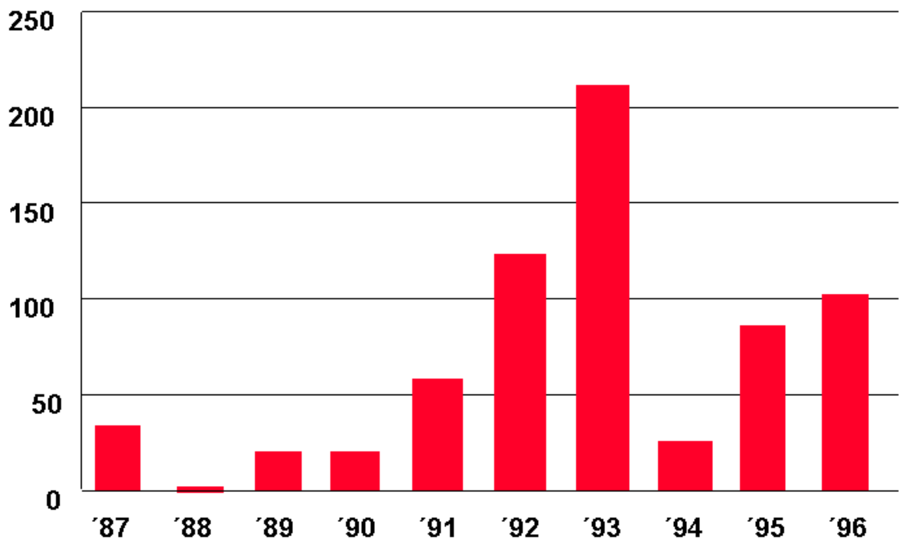
Germany is currently the third-largest industrial nation in the world and, since German reunification, it has had the highest population of any country in the European Union; in the wake of reunification, however, it has also changed from a capital-exporting country into a capital-importing one. The large current account surpluses which had prevailed until 1990 have turned into sizeable deficits.



But the era of Germany's current account deficits could soon be a thing of the past. After a seasonally adjusted positive balance was recorded in the second quarter of this year, I expect the German current account will show an annual surplus again in 1998 at the latest.

Net Purchases of Securities by Non-Residents

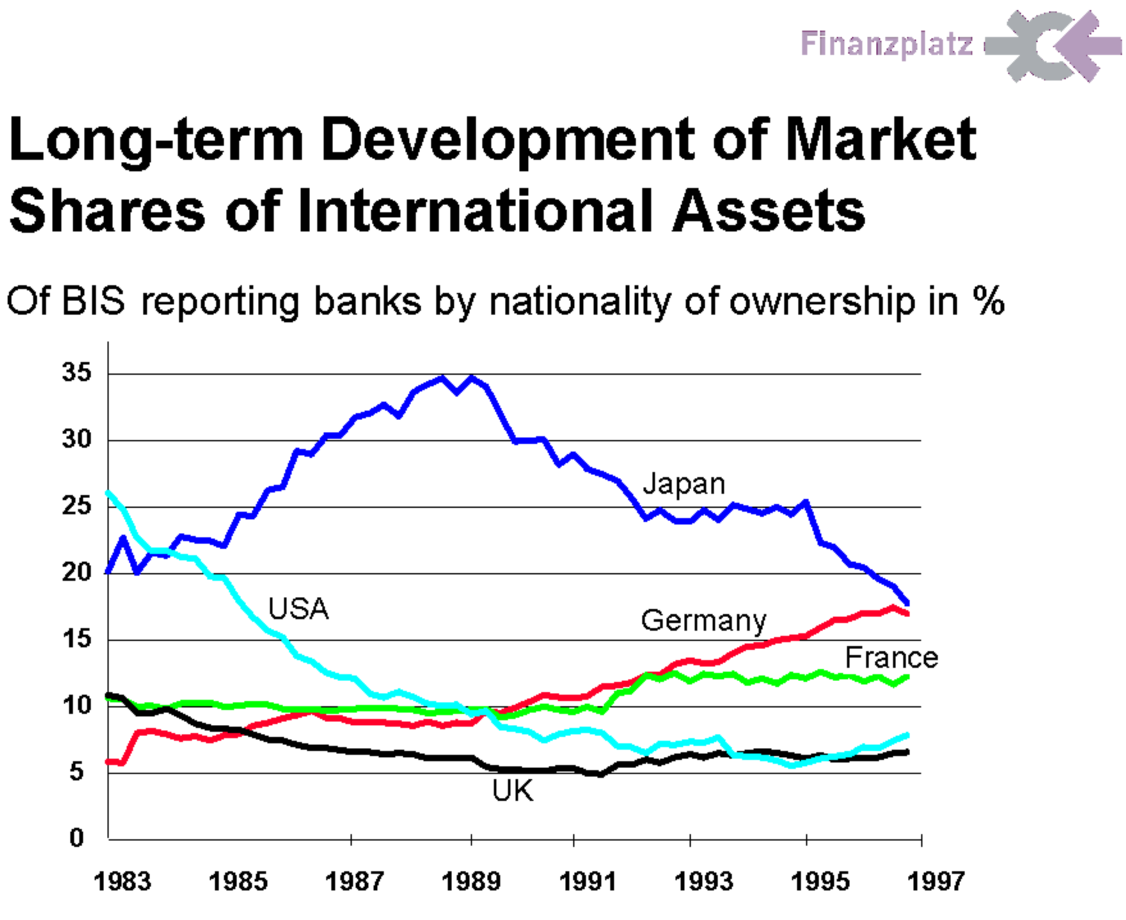
In billions of DM



The deficit on current account was covered in part by sales of fixed-rate bonds -- especially Federal securities -- abroad. In view of the D-Mark’s role as a reserve currency and the high creditworthiness of the Federal Republic of Germany as a borrower (triple A rating), it is not -- and never has been -- a problem for Germany to raise funds abroad. German banks are among the premier credit institutions worldwide in all sectors of traditional banking business. In only a short period of time they have diversified into new areas of business (investment banking, derivatives, etc.); here, too, they have meanwhile established professional and efficient lines of business.

This trend has been and is being accompanied by modernisations undertaken at the German stock exchanges, which are acquiring new structures, opening up new markets and, in doing so, consistently put their faith in the use of electronic systems. Concerning the speed, security and cost-effectiveness of securities trading, the German stock exchange Deutsche Börse leads the field. It has made rapid progress towards full computerisation and soon will offer a trading platform which will be trend-setting in the European context. The tool needed for this -- XETRA (Exchange Electronic Trading) is currently being implemented. The aim of XETRA is to facilitate full electronic handling of stock exchange trading with up to 40,000 securities -- with a worldwide remote membership facility. This will mean lower costs, more efficiency and a high degree of liquidity.

In this context the centralised securities settlement system of Deutsche Börse Clearing AG, the leading German stock exchange clearing house, deserves a mention. Its functionality and speed, together with its cost-effective settlement procedures, are unmatched internationally. In Germany, settlement is generally completed within just two days (T+2) -- if necessary, even on the same day; that is faster than anywhere else. And, for the sake of security, they are working on cutting the time even further. The question of deregulation proved to be a less pressing problem in the traditionally liberal German financial market than in other countries; however, in Germany, too, further steps in this direction were necessary. Thus -- to cite just a few examples -- the securities transfer tax was abolished in 1990. Since 1992, foreign non-banks have been able to issue commercial paper denominated in D-Mark.

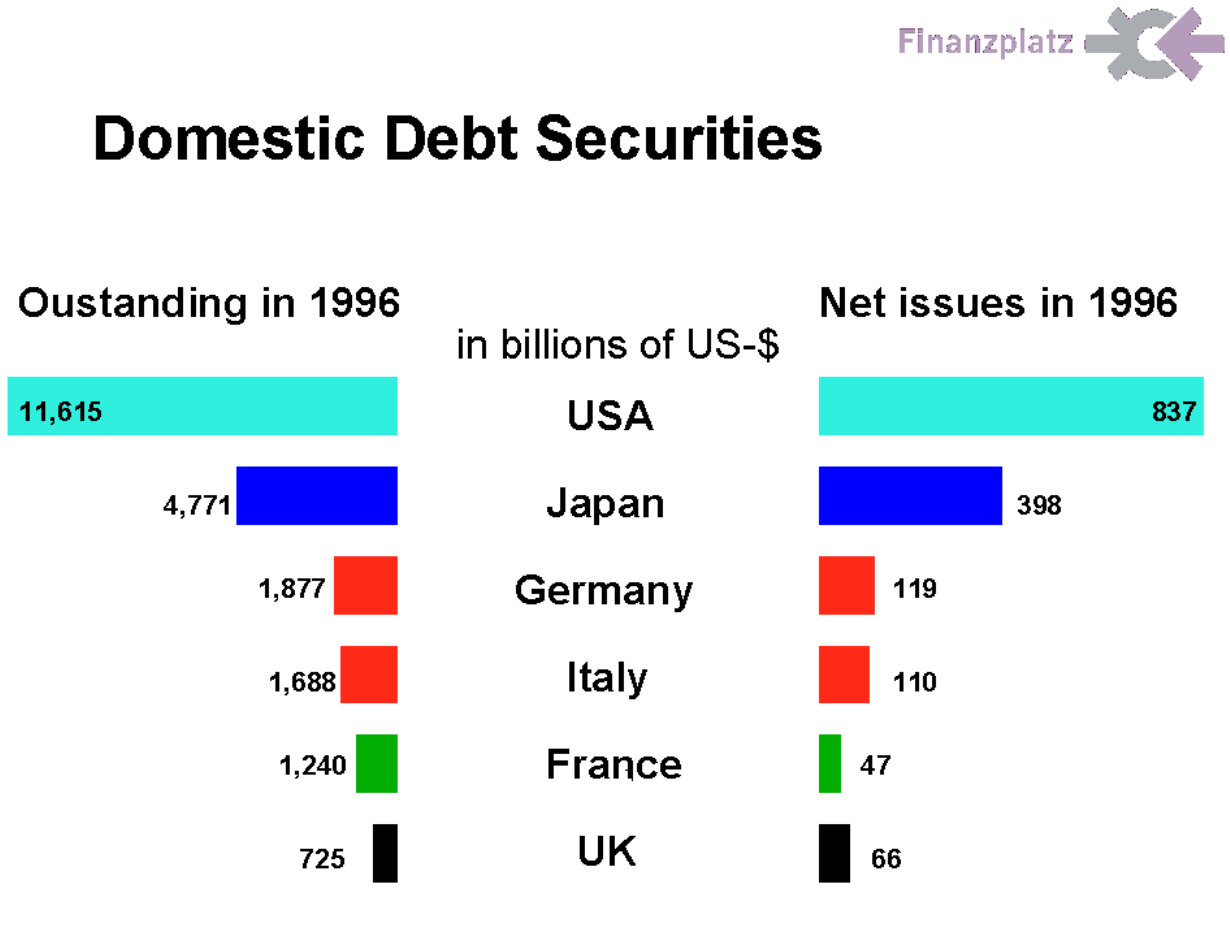


In 1994 investors' protection was reinforced by the establishment of the Federal Supervisory Office for Securities Trading and the legal ban on insider dealing. In 1994, too, genuine money market funds were admitted. In January 1997 minimum reserve requirements on repo transactions were abolished. In March 1997 the new stock exchange segment "New Market" was introduced for small and medium-sized fast-growing enterprises. Since May 1997, banks have been allowed to collateralise and sell loans in the form of asset-backed securities. Measured by the volume of securities outstanding, the German bond market is currently the third-largest debt securities market in the world. Within Europe it leads the field.

Approximately 40 per cent of the German government bonds outstanding are held by foreign investors. This shows that the long-standing benchmark position of German Federal bonds rests on a sound real base. And it is surely not surprising either that, with a 42% market share, the trade in D-Mark-denominated interest-related products is the leading business in the European financial futures exchanges. Annual net sales of fixed-rate bonds issued by German borrowers amounted to the equivalent of more than US$ 100 billion in each of the past few years. The primary and the secondary markets exhibit a very high degree of liquidity, especially in respect of Federal securities.

In order to maintain its leading position in the market, the Federal Government has gradually streamlined its array of issue instruments. Thus, the maturity range was complemented both at the short end ("Bubills") and at the long end of the market (30-year bonds). The further fixing of issue dates has meanwhile led in effect to a regular issuance calendar over the entire year. The concentration on standardised instruments and regular issue dates, in combination with re-openings of issues, ensures large and liquid issue amounts. The introduction of stripping for Federal bonds is likewise part of the strategy to protect the Federal Government's benchmark position. Whereas in the primary market the Government focuses on certain maturity segments, by allowing the stripping of government bonds it offers international institutional investors facilities for investment along the entire yield curve.

Some regional Land governments in Germany have meanwhile started to combine their issues into joint bonds, which has proved to be rather successful. Another important segment of the German debt securities market is constituted by mortgage bonds (Pfandbriefe) which, as “jumbo” issues, have met with a positive response in the international capital market for some time now. The picture is complemented by the German Financial Futures Exchange (DTB). Although it was established relatively late, it has already conquered a major market position.

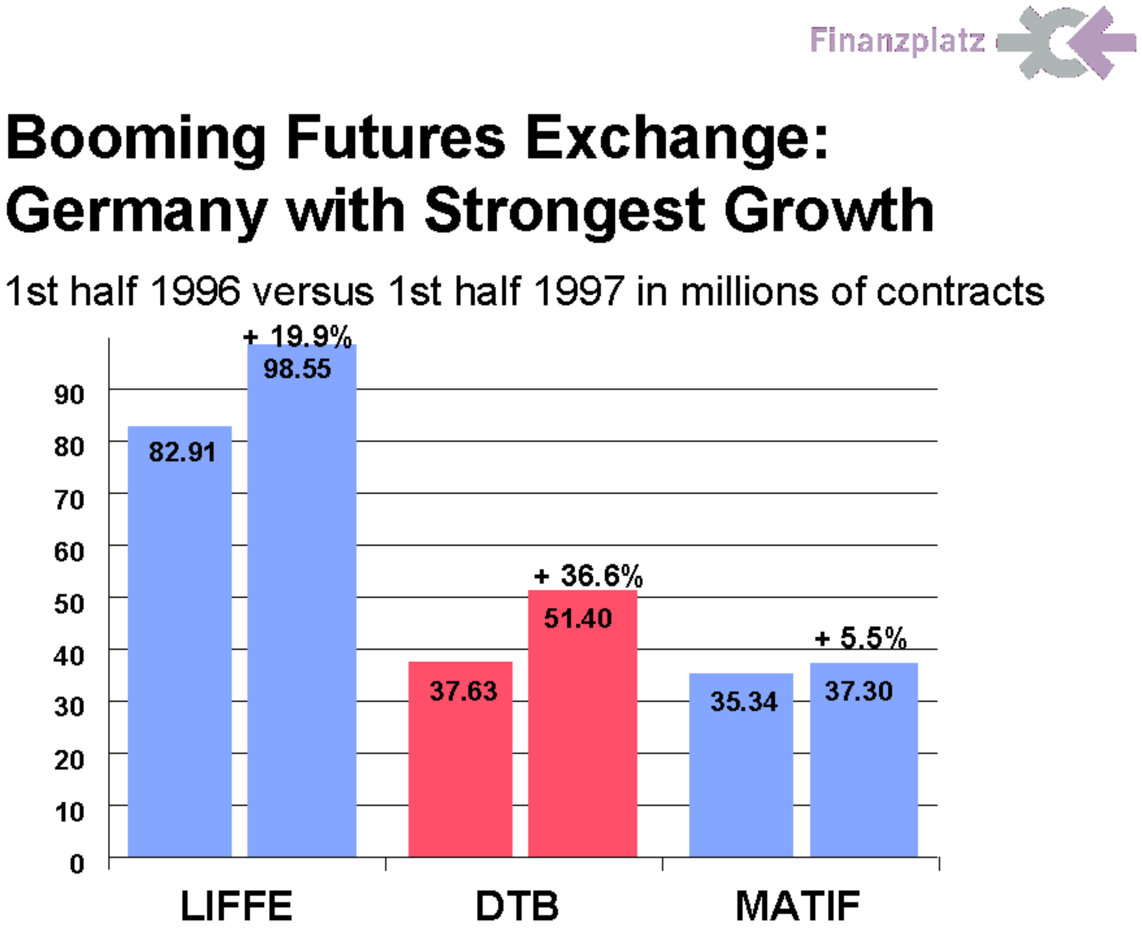


In conjunction with MATIF in Paris and SOFFEX in Zurich, the DTB is seeking to build a joint continental European trading and clearing platform. Not least because of its efficient settlement and its electronic access facilities installed in foreign financial centres, the DTB offers global capital market players access to all derivative business. In its efforts to catch up with the longer-established futures exchanges, it has already made ground especially with the introduction of the Bobl future; in this respect, it has even surpassed LIFFE. The DTB’s range of products meanwhile cover maturities from one month to ten years. Contracts such as the 1-month and the 3-month Euro-Mark future and the future on 2-year Federal Treasury notes are the most recent examples of the DTB’s market orientation.

2. Further capital market improvements in the pipeline

The launch of European monetary union will change the operating framework in Europe. Thus, the D-Mark will cease to exist as an internationally renowned reserve currency. For the emerging single currency area and the larger single financial market, a number of European Union directives will have to be incorporated into national law.

You may rest assured that in doing so we will endeavour to further strengthen Germany as a financial centre. These measures are being supported by practical considerations aimed at smoothing the transition from the D-Mark to the euro for capital market players. The Federal Government will do justice to its leading position as an issuer also by converting its marketable old issues to euros right at the start of monetary union on January 1, 1999. That will prevent any split in the market between D-Mark and euro-denominated Federal Government bonds. In other words, large and liquid euro issues covering the entire maturity range will be available from the outset.



With regard to the conversion procedures, due consideration has to be given, among other things, to avoiding costs and to agreeing general practical rules in the interest of ensuring a smoothly functioning capital market. This includes a simple and relatively cost-effective concept for bonds in respect of the conversion of (even) D-Mark nominal amounts into (odd) euro amounts, i.e. the so-called 1-cent method. As far as equities are concerned, conversion is likely to be facilitated by the introduction of stock based not on par values, but on divisible units. Thus an instrument which has long been common in the United States will be established in Germany, too.

To put it in a nutshell: the German capital market is itself in excellent shape and is or will be very well prepared for the future challenges.

3. Trends in other market sectors

3.1. Foreign exchange market

The launch of monetary union in Europe will definitely have far-reaching consequences for the foreign exchange market, too. Monetary union will lead to the elimination of dealings in currencies belonging to the European Monetary System. On the other hand, the odds are that the remaining foreign exchange dealings will concentrate further within continental Europe in favour of Frankfurt.

At a roughly constant level of trade in US dollars, German banks have been able to increase their operations in sterling, Swiss francs and yen distinctly already during the past few years. And further growth prospects look likely. Another cause of optimism is undoubtedly that Frankfurt will continue to be the location of one of the three central banks which issue the major international currencies, i.e. the US dollar, yen and euro.

3.2. Money market

In the German money market, too, progress has been recorded in the past few years. And the Bundesbank has made a major contribution to that. The list is headed by the drastic lowering of the minimum reserve ratios to a level of 1.5% to 2.0% in several stages up to 1995. That has lessened the incentives to circumvent the regulations while preserving the instrument's functional effectiveness. Since then the growth of short-term D-Mark-denominated deposits in the Euro-market has come to a halt. This effect has been reinforced by the exemption from minimum reserve requirements of liabilities under repo transactions with maturities of up to one year, which came into force at the beginning of this year. Within a short period of time this measure fostered the growth of a repo market in Germany and led to a shift of D-Mark-denominated repo business from the Euro-market, particularly London, back to Germany.

The set of monetary policy instruments of the future European Central Bank are expected to incorporate key elements of the Bundesbank's tried and tested toolkit. And I am convinced that even if the minimum reserve instrument is likewise employed, solutions will be found which exclude any negative effects on financial markets in the euro area, especially shifts to offshore financial centres.

In comparison to the existing national markets, the money market in the euro area is likely to become considerably wider and deeper. The harmonisation of market practices which is currently being vigorously pursued will create a level playing field conducive to boosting competition. A European Interbank Offered Rate (EURIBOR) is to be determined by a representative selection of banks from the euro area as the benchmark interest rate for the financial markets. It will enhance the profile of the European continent and of Frankfurt against London's Euro-Libor. The EURIBOR will establish itself as a major benchmark for derivative financial instruments such as options, futures, floating-rate notes, etc. The fast, smooth and secure settlement of money market transactions is ensured by efficient payment systems.

One of the linchpins of the Bundesbank's payment system facility is the Frankfurt Electronic Clearing System (EAF 2). This system is exceptional in that it combines the liquidity-conserving elements of a net settlement procedure with the risk-reducing features of gross settlement systems. The second linchpin is the express electronic intercity credit transfer system known as EIL-ZV. This gross settlement system will constitute the interface to the ESCB's TARGET system in stage 3 of EMU which links the national RTGS systems. Money market transactions within the euro area will then take just a few seconds.

4. Concluding remark

Ladies and Gentlemen, as you can see, Finanzplatz Deutschland -- the German financial centre -- is entering the European competition from a good starting position. We are in favour of an open exchange with other financial centres in Europe and are looking forward to this competition. No one should have any doubt that our ambition is to remain the best in those fields which we already lead and to become the best in those fields in which we are still trailing at the moment.

Colour charts for this text can be found on the BIS Website (for address see last page)