

German Finance Agency sets a benchmark in sovereign markets

The German Finance Agency has a unique involvement in the country's government bond market, helping to support the liquidity of the secondary market in the absence of primary dealers

Germany is the only large sovereign issuer of euro-denominated bonds that appoints no primary dealers. In all other large government bond markets, a selected group of international banks is committed to supporting the efficient launch and distribution of new bond issues at a primary level as well as a liquid market for the securities at the secondary level.

The German government's standard funding tools – six-month “Bubills”, two-year “Schatz”, five-year “Bobl” and 10- and 30-year “Bunds” – are sold via a group currently consisting of 33 international commercial and investment banks, known as the Auction Group Bund Issues. The sole obligation of each member of this group is to submit successful bids at the auctions for Bund issues that cover 0.05% of the government's total annual auction volume (weighted by duration). No other requirements are placed on the participating banks.

Features of the German bond market

Nevertheless, German government issues remain the acknowledged benchmarks for euro-denominated fixed income products. After solid auctions there is always a sufficient number of voluntary market makers to guarantee high levels of liquidity in the secondary market. Additionally the German Finance Agency is authorized to support the market makers by participating in both buy- and sell-side flows in the cash market and by being active in the market for repurchasing agreements (repos). This feature of the market, which is another way in which the German system is different from all other leading European government bond markets, supports the liquidity and therefore the attractiveness of the market for Bund products. For inflation-linked bonds, which are a new component of Germany's funding instruments, this practice has been especially well received by market participants.

When it auctions euro-denominated federal securities, the Finance Agency retains a proportion of the total auction volume for use in secondary market operations. That policy dates back to the days of the deutschemark, when the Bundesbank was responsible for the orderly development of the market for German government securities. Today, Germany's central bank continues to play a minor role in asserting daily fixings and fair pricing under the guidelines of the agency at the regional exchanges.

Over the counter

Since 2001, the agency has also shouldered responsibility for monitoring the development of off-exchange and over-the-counter (OTC) secondary market operations. It is also authorized to buy and sell Bunds in connection with its liquidity management responsi-

bilities, while in the interbank market the focus is on supporting the activities of market makers. The provision of this service is an efficient way of allowing members of the auction group to execute transactions in German government securities directly with the borrower at terms that match their requirements. The Finance Agency is committed to executing these deals in a market-sensitive manner and at prices that are in line with prevailing market levels.

Participating in the flows of German government securities gives the Finance Agency a valuable insight into the market performance of its outstanding issues. “Special” market and pricing

situations open to a range of interpretations by market participants can be better judged and evaluated thanks to the agency's direct presence in the market. It will only consider intervening, however, in circumstances in which it believes that the efficient functioning of the market could be jeopardized.

Direct trading in the market is complemented by repos and securities lending. In combination with direct trading, repos – which are used for both short-term liquidity

management and as a means of minimizing funding costs – are viewed as providing especially useful insights into the performance of the market. Securities lending, meanwhile, also supports the smooth settlement of transactions in federal bonds. Additionally, all the information gathered by the Finance Agency in the course of these auctions provides invaluable experience for the management of future auctions.

A single and consistent principle underpins the Finance Agency's initiatives in supporting the development of the market, which is that it never initiates nor intensifies existing trends. By cooperating with a number of leading international commercial and investment banks, and through the direct and indirect use of its own portfolio of securities, the Finance Agency is able to ensure that successful primary placements are made at prices that are in line with prevailing market conditions.

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