Box 2

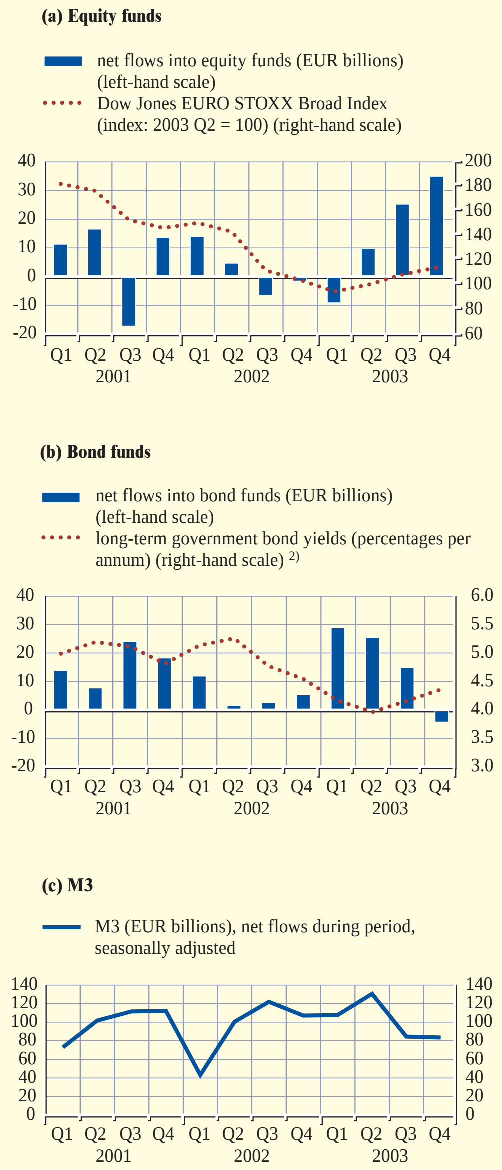
RECENT DEVELOPMENTS IN THE NET FLOWS INTO EURO AREA EQUITY AND BOND FUNDS

As yet, ECB statistics on investment funds do not distinguish between balance sheet changes arising, on the one hand, from valuation changes stemming from, for instance, asset price changes and, on the other, from changes in transaction data. Since the latter are of particular interest for studying the portfolio behaviour of the private sector, this box focuses on recent developments in transactions in euro area equity and bond funds on the basis of statistics made available by the *Fédération Européenne des Fonds et Sociétés d'Investissement* (FEFSI), the European investment fund sector association. These data provide information on net sales (or net flows) of publicly offered open-ended equity and bond funds.[1] Although FEFSI statistics are not fully comparable with available ECB statistics relating to end-of-period amounts outstanding, both datasets indicate that the assets of euro area bond and equity funds amounted to around €1,800 billion at the end of 2003. The following analysis uses FEFSI data as from the first quarter of 2001.

Developments since 2001 illustrate that net flows into equity funds have been closely associated with changes in stock prices as measured by the Dow Jones EURO STOXX Broad Index,

1 The countries included in FEFSI statistics on net flows of equity and bond funds are Germany, Greece, Spain, Italy, Luxembourg, Austria, Portugal, Finland and, as from 2003 Q3, also France.

Net flows into equity and bond funds in the euro area[1]



Sources: ECB, FEFSI, Reuters.
1) Data for equity funds, bond funds and M3 are quarterly sums; stock prices and bond yields are quarterly averages.
2) Bond yields refer to ten-year bonds or the closest available bond maturity.

i.e. strong demand for equity funds is correlated with rising stock prices and vice versa (see Chart, upper panel). Net flows into bond funds have often developed in an opposite direction to flows into equity funds (see Chart, middle panel). This suggests some existence of "flight-to-safety" portfolio shifts in the period under review. It is notable that between the second and the fourth quarter of 2002 the demand for both equity and bond funds remained very low. This period was characterised by high volatility in the bond market and especially in the stock market. Investors appeared to direct funds to the safest and most liquid financial assets such as short-term deposits. This was reflected in the high level of M3 flows in this period (see Chart, lower panel).

More recent developments, since the second quarter of 2003, indicate a renewed interest on the part of investors for equities, probably reflecting the declining stock market volatility observed after the end of the Iraq war. Net flows into equity funds rose considerably to reach €35 billion in the fourth quarter of 2003. At the same time, net flows into bond funds decreased considerably and reached negative levels in the fourth quarter of 2003 (-€4 billion). This may have partly reflected a reversal of earlier "flight-to-safety" portfolio shifts out of the stock market. In addition, the improved outlook for economic activity may have led to market expectations of possible capital losses on bond holdings stemming from future increases in bond yields.

The increases in net flows into equity funds since the second quarter of 2003 provide further evidence that investors may have started to unwind past portfolio shifts. This gradual shift towards longer-term and riskier financial assets outside M3 in the portfolio structure of euro area investors, in particular towards equity funds, partly explains the moderation in M3 growth during the latter half of 2003.