



ETFs – a niche product for private investors (for now)

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In focus: ETFs – a niche product for private investors (for now)

ETFs have gained popularity among private investors. In recent years, retail customers have expanded their investments in ETFs to approximately EUR 35 bn. They are also investing in ETFs via savings plans.

Nonetheless, ETFs remain a niche product for private investors given that the total assets in mutual funds amount to EUR 622 bn. ETFs primarily appeal to internet-savvy investors who do not demand financial advice.

Active ETF management is on the rise. On the one hand, private investors can choose from among a growing selection of ETFs tracking narrow sub-markets, topics or strategies. On the other hand, private investors are increasingly managing their ETF investments actively.

With bank deposits bearing little or even negative interest, conventional ETFs are becoming more attractive as a passive investment strategy for traditional savers: Contributing regular savings to and/or holding ETFs on large market indices presents the prospect of long-term valuation gains at comparatively low cost and risk.

Bank lending and household deposits in Q3 2019

In Q3, lending to private households set another record with volumes surging EUR 17.9 bn qoq. Yoy growth was a remarkable 4.6%, marking 10 years of uninterrupted expansion. Mortgages rose EUR 16.3 bn qoq, an all-time high. Consumer loan growth flagged a bit, reaching a modest EUR 1.2 bn qoq.

The narrowing trend in mortgage margins, in place since 2012, came to an end in Q3. Banks' higher refinancing costs and balance sheet constraints were the main reasons. Unlike mortgages, though, margins declined for both average and risky consumer loans.

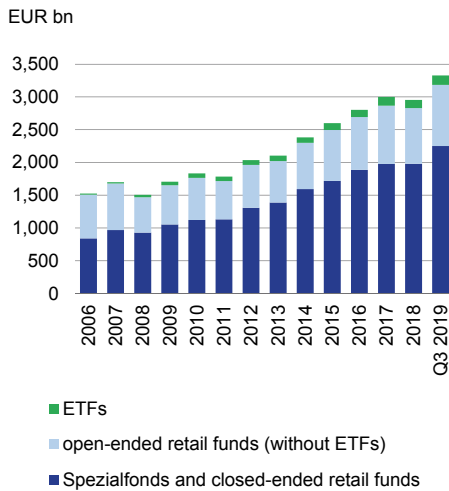
Deposits saw a weak EUR 13.6 bn qoq rise, the smallest figure in seven quarters. Yoy growth slowed to 5.4%. Some banks are imposing negative rates on deposits, leading to negative sentiment among German savers.



ETFs – a niche product for private investors (for now)

Fund assets of private and professional investors in Germany

1



Sources: BVI, Deutsche Bank Research

Exchange-traded funds in Germany

In Germany, at least EUR 144 bn is held in exchange-traded funds (ETFs).¹ In other words, ETFs account for 13% of the assets in open-ended retail funds, even though the first ETFs were only listed on Deutsche Börse in 2000. Institutional investors hold the majority of ETF assets, though 15-20% are held by private investors, according to industry estimates.

ETFs were originally introduced in Germany as passive funds that track the composition of a broad market index (e.g. MSCI World, Euro Stoxx 50, Dax). In contrast to conventional mutual funds, ETF shares are listed and traded on a stock market.² In order to invest in ETFs, retail clients only need a securities account and a broker. In most cases, ETF shares can also be bought and sold over-the-counter through electronic trading platforms.

ETFs that track large market indices enable especially retail investors to invest in the capital markets at low cost and with broad risk diversification, as the management fees are usually lower than those of actively managed mutual funds.

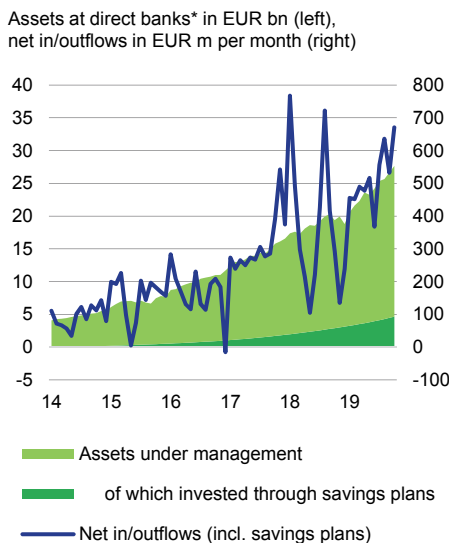
ETFs and private investors: Strong growth, small size

ETFs have gained considerable popularity as an investment option among private investors. Retail customers have expanded their investments in ETFs multiple times in recent years to approximately EUR 35 bn. The ETF business with private households is conducted largely online through direct banks, where approximately EUR 27 bn of retail ETF assets are held. Over the past five years, the direct banks have seen almost uninterrupted net inflows. In addition, an estimated EUR 4-6 bn is invested in ETFs through other banks and up to EUR 3 bn through robo-advisors. Despite this impressive development, ETFs remain a niche product considering that the total investments by German private households in mutual funds amount to EUR 622 bn.³

Private investors are also increasingly investing in ETFs via savings plans. The number of savings plans has grown to 1.1 m, with the average monthly savings contribution climbing to EUR 162 in September 2019. To date, private customers have invested roughly EUR 4.5 bn in ETFs through this channel. There is a large and varied range of savings plans on offer, with features such as a choice of ETF or flexibility in savings contribution as well as fee models.

ETF assets held by private households in Germany on the rise

2



*Aggregated data from 10 direct banks in Germany
Sources: extraETF, Deutsche Bank Research

ETFs go active

ETFs no longer mean passive asset management in all instances. Indeed, there is a move towards active investment behaviour.

This is evident from a broadening of the ETF product range and a simultaneous trend towards specialisation among individual ETFs offered to private investors. There are now ETFs that track not only the well-known indices of large stock markets, but also an array of sub-markets, topics and strategies such as fixed income, commodities, individual sectors, volatility indices, or sustainability. Active ETFs weight their portfolios in accordance with certain strategies. There are also new products available that are “exchange-traded” but not “funds”. These

¹ German Investment Funds Association (BVI), as of Q3 2019. According to the BVI, the attribution of ETFs to the German market is not comprehensive, as especially ETFs issued in Ireland are not fully recorded. For this reason, the reported volume has to be regarded as a lower bound.

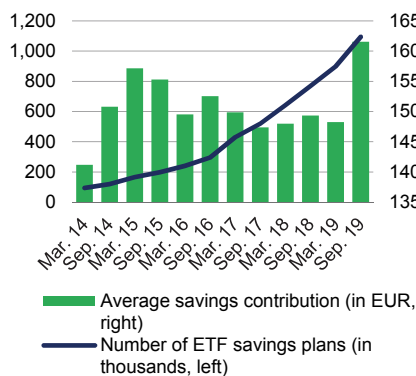
² A comprehensive description of ETF trading can be found in Deutsche Bundesbank, The growing importance of exchange-traded funds in the financial markets, Monthly Report October 2018, pp. 79-101.

³ Deutsche Bundesbank, Statistics on securities holdings, August 2019.



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ETF savings plans growing in popularity* 3



*Aggregated data from 10 direct banks in Germany

Sources: extraETF, Deutsche Bank Research

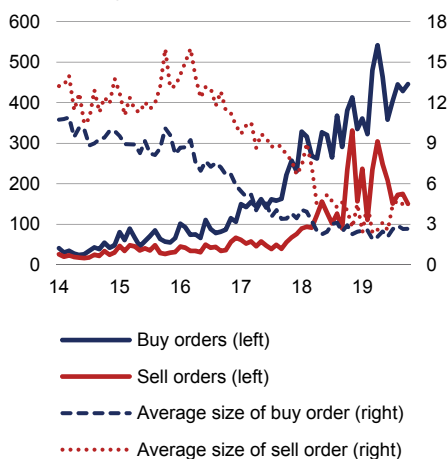
include debt securities such as exchange-traded commodities (ETCs) and exchange-traded notes (ETNs).⁴ Choosing an ETF that tracks a narrow or a strategy index reflects the expectation that this segment will show a better performance than the overall market, which a broad index would track.

There is also a growing trend towards private investors actively managing their ETF investments, as indicated by their increasing trading activity. The number of ETF orders (apart from savings plans) has seen a particularly sharp rise since 2017, in parallel with the volatility of trading activity. Meanwhile, the average size of each order fell to EUR 2,659 (buy) and EUR 4,484 (sell) in September 2019, with the number of buy orders exceeding sell transactions by a factor of two or three in most months.

However, studies suggest that returns for private investors from active ETF management are lower over the long run than returns from holding a less expensive ETF on a broad index would have been, as retail investors could not beat the market due to poor transaction timing and the selection of specialised ETFs.⁵

Private households: More ETF transactions, smaller orders* 4

Buy/sell orders in thousand transactions per month, order size in EUR thousands (monthly average); without savings plans



*Aggregated data from 10 direct banks in Germany

Sources: extraETF, Deutsche Bank Research

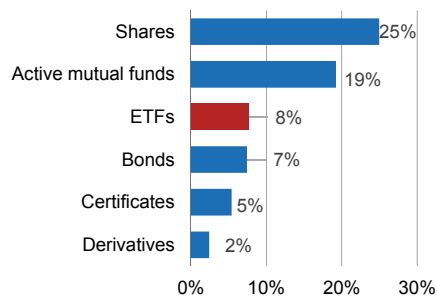
Out of the niche?

So far, few private investors use ETFs. Only 8% hold or used to hold ETFs, compared to 25% with investments in shares and 19% in conventional mutual funds. That is because ETFs are a low-cost product for self-directed investors. In buying an ETF, there is no issue surcharge to pay for investment advice as is the case with conventional funds. Thus, ETFs are largely sold through online channels and without personal financial advice. As a result, (potential) ETF investors are largely private individuals who feel knowledgeable about financial transactions and are familiar with online brokerage. Even robo-advisors which provide digitalised financial advice, have failed to tap into new customer segments for ETFs.

However, the sustained low-interest-rate environment makes it likely that traditional savers will increasingly familiarise themselves with ETFs. More and more credit institutions are passing on the ECB's negative interest rate to retail customers, which may cause many households to reassess their previous savings and investment decisions. Unlike bank deposits, ETFs represent an asset class that is subject to liquidity risk and fluctuations in value. However, ETFs can be an attractive alternative when compared to other asset classes. Notably, savers who do not want to make frequent changes to their investments stand to benefit from ETFs as a form of passive investment: contributing regular savings to and/or holding ETFs in large market indices provides potential for long-term valuation gains at comparatively low cost and risk.

8% of German citizens hold or used to hold ETFs 5

Share of private individuals that hold or used to hold securities (representative survey, 2019)



Sources: ebase, Deutsche Bank Research

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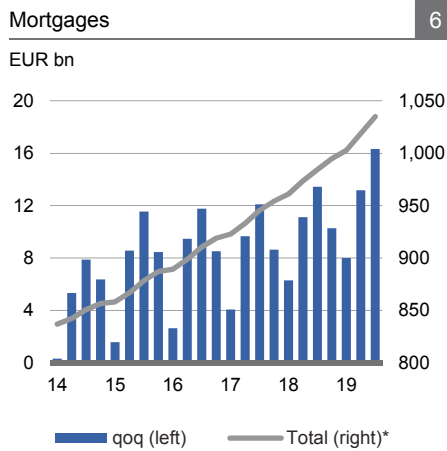
⁴ Unlike with ETFs, which have special fund status, investors in such securities lose their money if the issuing company goes bankrupt.

⁵ Bhattacharya, U., Loos, B., Meyer, S., Hackethal, A., Abusing ETFs, 2012.



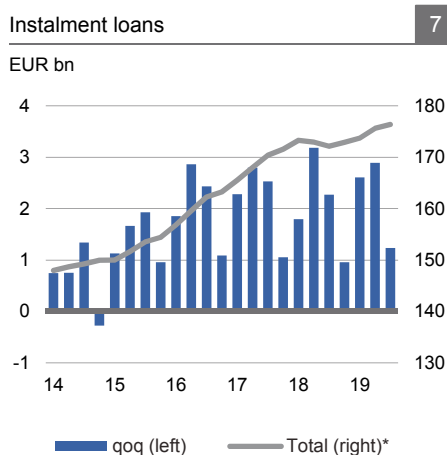
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Bank lending and household deposits



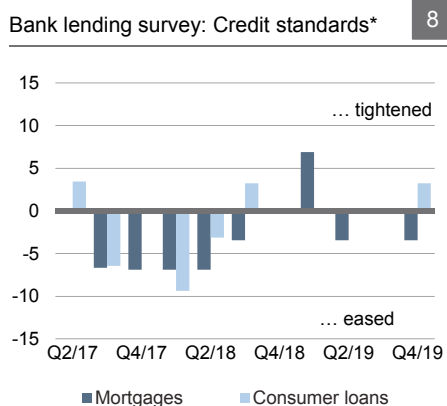
*includes significant reclassification in Q3 18.

Source: Deutsche Bundesbank



*includes significant reclassifications in Q2 & Q3 18.

Source: Deutsche Bundesbank



*Q4/19 expected value

Source: Deutsche Bundesbank

Loan volumes

In Q3, lending to private households set another record. Loan volumes surged by EUR 17.9 bn compared to the previous quarter. Year-over-year growth went up further to 4.6%, marking 10 years of uninterrupted expansion.

Mortgages rose EUR 16.3 bn qoq, an all-time high. Annual growth reached 4.9%. Total net new mortgage lending in the first three quarters of 2019 stood at an impressive EUR 37 bn. In Q3, cooperative banks and savings banks achieved the largest-ever increases (EUR 5.2 bn and EUR 4.8 bn, respectively – both record figures). Large banks expanded their lending by a notable EUR 3.2 bn too. While the activation of the countercyclical capital buffer in Germany might dampen lending, its effect will probably be limited. German households' preference for longer-term fixed-rate mortgages continued: mortgages with a rate fixation period of 10 years or more accounted for 52% of total new mortgage lending, up from 47% a year ago. During the last ten years or so, property prices (country-wide, for existing and new flats) were up 5% p.a. on average, rising even more in recent years thanks to supply-related bottlenecks. With the underlying collateral value climbing, refinancing should not be a problem for those loans that have not been fully repaid. Moreover, a strong labour market (unemployment down to 4.9% in Q3) and rising real disposable incomes (+1.3% yoy in Q2) continue to create favourable homeownership dynamics. The debt-to-income ratio of German households, which climbed to 84.5%⁶ in Q2 2019, from 83.3% a year earlier, is a metric to watch.

In Q3, consumer loan growth flagged a bit. With a modest EUR 1.2 bn qoq uptick, yoy growth slowed to 4.5%, the lowest figure in three years. The entire increase came from foreign banks, which provided EUR 1.7 bn in new consumer loans. Net lending by savings banks and cooperative banks was negligible. At EUR -0.1 bn, the loan flow of large banks was negative. Debit balances inched up a moderate EUR 0.4 bn qoq and other loans were down a slight EUR 0.5 bn. Annual growth for debit balances rose to 0.7% and remained negative at -0.4% for other credits.

In Q3, a remarkable 28% of banks saw a rise in demand for mortgages, according to the bank lending survey (BLS). The level of interest rates and benign housing market prospects were the main background factors, as indicated by a net 28% and 17% of banks, respectively. A net 6% of banks reported an upturn in consumer loan demand. 10% of banks named low interest rates as the main factor, while 6% cited spending on durable goods such as cars and furniture. Banks are optimistic for the current quarter, with 17% and 6% foreseeing a further rise in demand for mortgages and consumer loans, respectively.

Credit standards for approving loan applications

Mortgage standards remained unchanged in the summer quarter. A small 3% of banks expect to ease their standards in the current quarter. Standards for consumer loans were also flat, while a slim 3% of banks expect to tighten in Q4. 7% (3%) of banks reported a higher share of rejected mortgage (consumer loan) applications. According to the ad-hoc questions of the BLS, the ECB's asset purchase programme (APP) did not affect German banks' lending standards at all. Yet both the APP and the negative deposit rate contributed to higher lending volumes, a desirable outcome from a policy-making point of view.

⁶ ECB (2019). Household Sector Report Q2. November 11, 2019, p. 25.



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Terms and conditions governing loan contracts

The narrowing trend in mortgage margins, in place since 2012, came to an end in Q3. A notable 17% of banks reported wider margins on average loans. Even more significantly, margins on riskier mortgages rose at 28% of banks, with banks citing higher refinancing costs and balance sheet constraints as the main reasons. For riskier loans, banks' risk perception and reduced risk tolerance contributed to the widening, too. Unlike mortgages, margins declined for both average and risky consumer loans (reported by 10% of banks). On this front, pressure from competition was the main factor.

Deposit volumes

In absolute terms, deposits saw a weak EUR 13.6 bn qoq uptick in Q3, the smallest figure in seven quarters. Yoy growth slowed to 5.4%. At EUR 17.2 bn qoq, private households only just expanded their sight deposits. Savings deposits had significant outflows of EUR 3.6 bn, and time deposits were essentially flat. While rock-bottom yields have not impacted savings to date, the fact that some banks are imposing negative rates on deposits (at least for volumes of EUR 100,000 or more) is leading to negative sentiment around saving.

Among different banking groups, savings banks and cooperative banks saw the largest spikes in sight deposits at EUR 7.5 bn qoq and EUR 6.2 bn, respectively. Banks' net bond issuance was a negative EUR 5.7 bn. While it is too early to flag problems, the environment for bank refinancing was not particularly favourable in Q3.

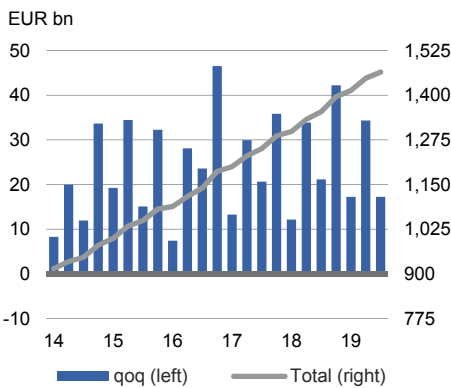
Interest rates

Since Q1, overnight deposit rates have been stuck at a symbolic 0.01% (EMU average: 0.03%) and are unlikely to rise anytime soon. The average rate for new mortgages in Q3 was down by an impressive 29 bp to a new record low of 1.34%. Since the start of the year, the mortgage-rate spread between Germany and the EMU average has widened and reached 43 bp in Q3. In September, the 10-year Bund yield fell to -0.57%. Correlation between the 10-year Bund yield and mortgage rates is around 98% and the downward trend in benchmark rates is the main reason for the decline in mortgage rates. Rates for new consumer loans were 14 bp lower at 5.92% (EMU: 6.24%).

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Sight deposits

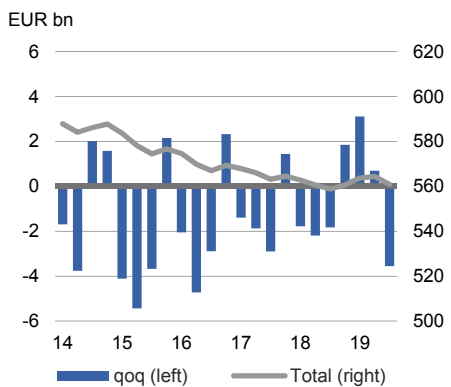
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Source: Deutsche Bundesbank

Savings deposits

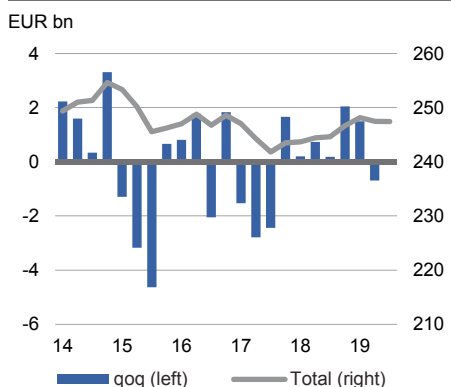
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Source: Deutsche Bundesbank

Time deposits

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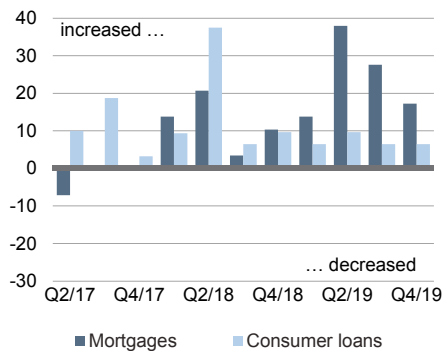


Source: Deutsche Bundesbank



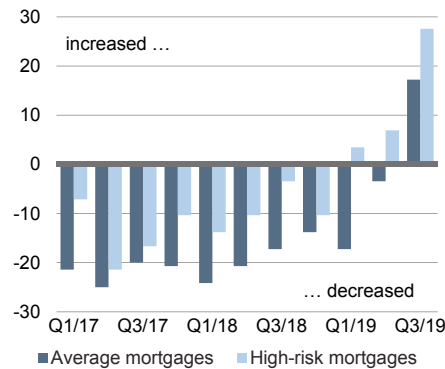
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Bank lending survey: Credit demand* 12



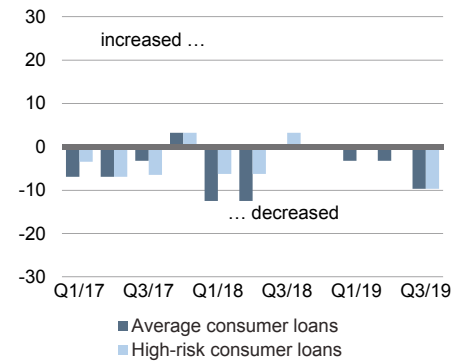
*Q4/19 expected value
Source: Deutsche Bundesbank

Bank lending survey: Mortgage margins 13



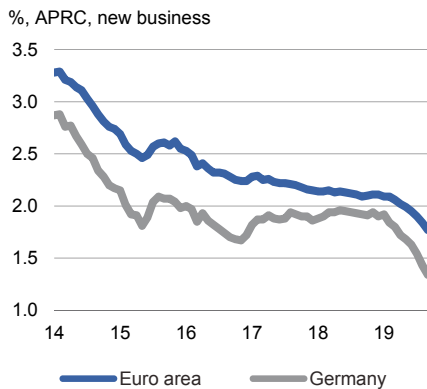
Source: Deutsche Bundesbank

Bank lending survey: Consumer credit margins 14



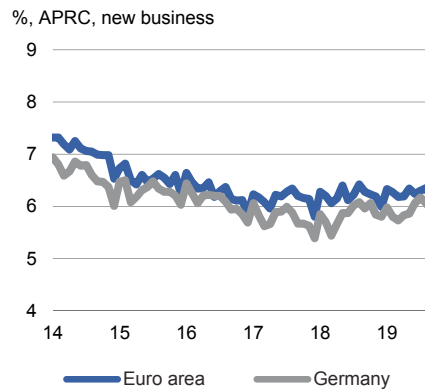
Source: Deutsche Bundesbank

Mortgage rates 15



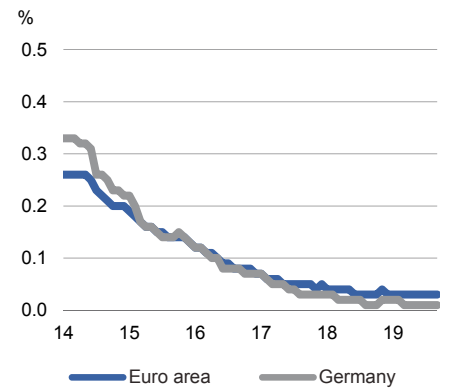
Source: ECB

Consumer credit rates 16



Source: ECB

Overnight deposit rates 17



Source: ECB

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