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Primary Market Demand for German Government Bonds

- Extended abstract -

Selling bonds to banks via auctions is by far the most important way of issuing government debt in advanced economies. Moreover, while price discovery mostly takes place in the trading of existing government bonds (the secondary market), it is the primary market where the actual cost of debt is determined. However, there exists little scientific evidence on the factors affecting the banking system's willingness and capacity to absorb the supply of newly issued government bonds. Using detailed proprietary data of the German federal debt management agency (Deutsche Finanzagentur) on approximately 600 bond auctions this paper analyses the determinants of primary market demand for German government bonds.

To capture different characteristics of the empirical demand curve of each auction five different measures of demand are derived. These measures of demand are then regressed on up to 23 potential determinants using weighted-average least squares (Magnus/Powell/Prüfer 2010) and seemingly unrelated regressions (Zellner 1962).

The main results are as following: The secondary market yield of the government bond to be issued has a robustly positive effect on demand, while risk – as measured by implied bond future volatility – has a negative effect. Demand volume increases with the offered volume, which is in accordance with both auction theory and institutional aspects. Additionally, the pricing-aggressiveness of the issuer in previous auctions negatively affects demand, while the announcement of upcoming syndicated bond sales increases demand. The demand for bonds is positively affected by central bank bond purchases in the secondary market. Lastly, in contrast to frequent claims in financial sector research notes, I do not find evidence of crowding-out-like effects where competing bond issuance of comparable issuers would decrease the demand for German government bonds.

Disclaimer: The views expressed here do not necessarily represent those of the Deutsche Finanzagentur. Furthermore, all results are preliminary and therefore should not be cited.