Monetary policy and banking business

Monetary policy and money market developments

Key interest rates remain at historical low

Since the main refinancing rate and the marginal lending rate were lowered by 25 and 50 basis points respectively in May 2013, the Governing Council of the ECB has left key interest rates unchanged. The interest rate on main refinancing operations therefore remains unchanged at 0.50%. The rates for the deposit facility and the marginal lending facility stand firm at 0.00% and 1.00% respectively.

These decisions are based on the ECB Governing Council's unaltered expectation that underlying price pressures in the euro area will remain subdued over the medium term. This is also indicated by the still subdued monetary and credit growth. The ongoing accommodative monetary policy stance is intended to support the gradual recovery in economic activity for the remainder of the year and for 2014.

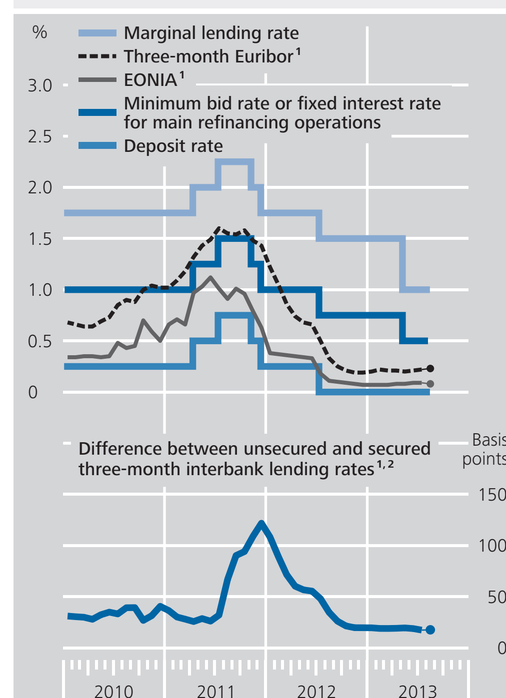
ECB Governing Council provides forward guidance on its future monetary policy stance

After its meeting on 4 July 2013, the ECB Governing Council made it clear that it expected to keep key interest rates at present or lower levels for an extended period of time. This must be seen against the backdrop of the fact that, despite the reduction in policy rates at the beginning of May, the level of money market forward rates had not fallen permanently. The ECB Governing Council has thus provided "forward guidance" on the future orientation of its monetary policy (see box on pages 30 to 32). This assessment depends on the medium-term outlook for inflation, which is based on expectations regarding future developments in the real economy and on the dynamics of credit and monetary aggregates. The ECB Governing Council underlined that the forward guidance on its future monetary policy stance is entirely compatible with the primary objective of price stability and the Eurosystem's monetary policy strategy. Following its meeting on 1 August, the ECB Governing Council repeated the phrase it had first used in July regarding its expectations on the development of key ECB interest rates.

Modifications to the ECB's risk control framework

On 18 July 2013, the ECB Governing Council published several modifications to its risk control framework for the acceptance of collateral. These modifications included adjusting valuation haircuts for marketable instruments and tightening risk control measures for retained covered bonds. In addition, the rating requirements for six classes of asset-backed securities (ABS), which are subject to loan level reporting requirements, were lowered from two "triple A" ratings to two "single A" ratings, and valuation haircuts for ABS, which serve as collateral for monetary policy operations within the standard or temporary collateral framework, were reduced. Finally, the eligibility criteria and haircuts applied by the national central banks

Money market interest rates in the euro area



1 Monthly averages. 2 Three-month Euribor less three-month Eurepo. • Average 1 to 14 August 2013.
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Forward guidance – an indication of monetary policy stance in the future

Essentially, a stability-oriented monetary policy influences price developments by impacting on aggregate demand. One central transmission channel leads from the key interest rates, feeding through short-term money market rates to longer-term interest rates, which are ultimately key variables in the borrowing and purchase decisions of households and enterprises. However, this means of indirectly influencing longer-term interest rates may be weakened if, for example, key interest rates cannot be lowered further – perhaps because they have reached their lower bound, or other factors are affecting developments in longer-term interest rates. Such factors may be influences from abroad, for instance, or uncertainty-induced changes of the risk premiums in these interest rates.

One basic option a central bank has for exercising more direct influence on longer-term interest rates is forward guidance. This refers, above all, to indications which a central bank provides regarding the future development of its key interest rates. If such indications contain new information or reduce uncertainty about how the key rates will develop in future, this should have a corresponding impact on longer-term interest rates. Against this backdrop, it is not surprising that central banks around the world have in recent years adopted this approach to communicate their monetary policy orientation for the future.

Forward guidance issued by the Eurosystem

The Eurosystem recently used such a tool for steering expectations, too. After its meetings on 4 July and 1 August 2013, the ECB's Governing Council voiced the expectation that the key interest rates for the euro area would remain at present or lower levels for an extended period of time.[1]

To interpret this forward guidance correctly, however, it is crucial to understand that it is conditional on the Eurosystem's unchanging commitment to its mandate, which is to maintain price stability by keeping inflation rates below, but close to, 2% in the medium term.[2] Thus, in issuing this forward guidance, the Eurosystem is not making an unconditional promise with regard to the future development of key interest rates, but is describing its monetary policy response – in light of the current data set and based on its two-pillar strategy – to the expected inflation developments.

The ECB's Governing Council has therefore not committed itself: its forward guidance does not rule out a rise in key interest rates if signs emerge that price pressures are more pronounced than currently estimated. By the same token, a weaker development would not rule out a cut in the key interest rates. It was to stress the conditionality of this forward guidance and to avoid any misunderstandings that a specific time horizon was not given.

Thus, the indication of the future monetary policy stance is given in the context of the current mandate and is consistent with the current monetary policy strategy. The additional information concerning the future monetary policy stance supplements previ-

1 See European Central Bank, Editorial, Monthly Bulletin, July 2013, pp 5-9.
2 See also European Central Bank, The monetary policy of the ECB, 2011.

ous communication with the public, which has grown more difficult, particularly in times of heightened uncertainty, and therefore more challenging. The aim is to explain the monetary policy orientation even more simply and clearly in order that it is understood by as many market participants as possible, and that the Eurosystem's forward guidance is adequately reflected in longer-term interest rates.

Forward guidance by the US Federal Reserve

The US Federal Reserve (Fed) has provided the markets with an indication of its future monetary policy for some time now. However, the Fed's variant of forward guidance differs from that of the Eurosystem. On 12 December 2012, it specified thresholds for inflation and unemployment to the effect that the federal funds rate (US key interest rate) would remain at its current exceptionally low level at least as long as the unemployment rate remains above 6½%, inflation between one and two years ahead is projected to be no more than ½ percentage point above its 2% goal, and the longer-term inflation expectations continue to be well anchored.[3]

In issuing this forward guidance the Fed, too, is not changing its monetary policy strategy, but is merely spelling out in more precise terms its approach to carrying out its dual mandate, which is to ensure price stability and high employment levels. And much like the Eurosystem, this is not an unconditional commitment to a specific interest rate path. The Fed may deviate from the path it set out if any of the three above preconditions with regard to unemployment, inflation and inflation expectations are not fulfilled. Thus, its monetary policy decisions are likewise subject to how economic developments actually turn out.

Forward guidance as provided by these two central banks is, therefore, based on their respective monetary policy strategy and depends on their respective data set, making it primarily an instrument for improving communication with market participants. The main difference between the forward guidance given by the two central banks probably lies in the use of specific thresholds. For the Eurosystem, the present quantitative definition of price stability represents the value for the overarching objective of price stability in keeping with its mandate. Reference values such as the growth of money and credit supply are not monetary policy objectives in their own right.

Forward guidance at the lower bound of interest rates

Providing forward guidance on the future path of key interest rates is, in principle, also a means of dampening longer-term interest rates at the lower bound of interest rates, ie when there is *de facto* no further scope for key interest rate cuts. A credible announcement to the effect that key interest rates are to remain at a low level longer than the above-described monetary policy strategies imply would be the simplest way of committing to a phase of higher inflation for the future. The inflation expectations that are increased by such an unconditional commitment have the effect of lowering – on the basis of a given nominal interest rate – the ex-ante real interest rate, and of stimulating macroeconomic demand.

However, central banks can only achieve their aim of higher inflation expectations by generating a temporary increase in inflationary expectations over and above the present price stability mark. This is likely to

3 See Board of Governors of the Federal Reserve System, Press Release, 12 December 2012.

greatly impair central banks' credibility, however, particularly when monetary policy is going through a difficult period, as the impression would arise that central banks are willing to change their strategy and their mandate to attain short-term objectives. The central banks would then risk losing their means of systematically steering expectations at the lower bound of interest rates. This also explains why no central bank engages in this form of unconditional forward guidance.

Conclusion

To sum up, the forward guidance provided by the Eurosystem must be seen in the context of its mandate and its unchanged monetary policy strategy. For this reason, its forward guidance indications are not likely to affect medium to long-term inflation expectations either. Particularly in times of heightened uncertainty, the form of forward guidance the Eurosystem has chosen can enhance communication with market participants, spell out its monetary policy stance in clearer terms and check expectations about the future path of short-term interest rates which the ECB's Governing Council considers wide of the mark.

for pools of credit claims and certain types of additional credit claims (ACC) were adjusted. The ECB Governing Council stated that these measures, taken together, would have a neutral effect on the overall amount of eligible collateral available.

Still no bond purchases in the form of Outright Monetary Transactions (OMT)

In the second quarter of 2013, the Eurosystem again did not make any purchases as part of monetary policy-based bond purchase programmes. In particular, purchases were still not being made in the form of Outright Monetary Transactions (OMT). The Eurosystem's holdings of securities acquired under the Securities Market Programme (SMP), which was discontinued in 2012, amounted to €192.6 billion in mid-August; holdings totalling €59.9 billion were accounted for by the two covered bond purchase programmes, which have likewise been discontinued in the meantime.

Monetary policy refinancing volume and excess liquidity down

Recourse to monetary policy refinancing operations by euro-area banks declined further in the second quarter of 2013. This was once again mainly due to early repayments of the liquidity provided in the two outstanding three-year refinancing operations. The monetary policy counterparties to these two operations have voluntarily repaid to the Eurosystem around €320 billion in total and around €82 billion since April. The sum of repayments has decreased from month to month. It is likely that the lower incentive for early repayments of excess liquidity to the Eurosystem – which resulted from the interest rate corridor being narrowed in May 2013 – contributed to this. The volume of liquidity outstanding from the two three-year refinancing operations currently stands at €672 billion of an original €1,019 billion. Excess liquidity dropped to €248 billion of late on average over the reserve period that ended on 6 August 2013. This was still an unusually high figure compared with the period prior to the allotment of the two three-year tenders.

Money market management and liquidity needs

Liquidity provision to credit institutions in the euro area was still well above the calculated liquidity needs during the three maintenance periods from 10 April to 9 July 2013. At the same time, excess liquidity (deposit facility plus current account holdings minus the reserve requirement) fell from, on average, €332 billion in the April-May period to €274 billion in the June-July period. This was mainly due to the early repayment of the liquidity allotted in the three-year tenders, amounting to €64.8 billion. Other contributing factors included lower tender demand, maturities under the securities purchase programmes initiated as part of the ECB's monetary policy and an increase in autonomous factors. Liquidity-providing open market operations continued to be carried out as fixed-rate tenders with full allotment of the submitted bids (see table on page 35). In addition, at its meeting on 2 May 2013, the Governing Council of the ECB decided to continue this full allotment policy both in main and longer-term refinancing operations at least until the end of the June-July 2014 maintenance period. Given the generous liquidity conditions, overnight rates remained in line with the deposit facility rate of 0% during the review period but were, on average, nonetheless marginally higher than the values observed in the first three maintenance periods of 2013.

The net increase of €10.2 billion in liquidity needs stemming from autonomous factors in the three maintenance periods was mainly owing to the volume of banknotes in circulation which, on balance, grew by €20.1 billion. This, in turn, absorbed a similar amount of liquidity as in the comparable 2012 period, in which liquidity needs went up by €21.3 billion on the back of a growing volume of banknotes in circulation. Government deposits increased by €2.8 billion and therefore also absorbed liquidity. The sum of changes in net foreign assets and other factors, which are looked at together in order to eliminate valuation effects with no impact on liquidity, had the opposite effect. It swelled by €12.7 billion in the period under review, thus reducing the need for central bank liquidity. Liquidity needs stemming from the minimum reserve requirements remained virtually unchanged on balance over the three maintenance periods.

In the period under review, maturities lowered balance sheet holdings under the Securities Markets Programme (SMP) by €10.4 billion to €195.5 billion – including revaluations. The weighted allotment rate in the customary weekly fine-tuning operations to absorb the liquidity provided under the SMP increased from 0.04% to 0.09%. Maturities and revaluations reduced balance sheet securities holdings under the Covered Bond Purchase Programmes (CBPP1 and CBPP2) by €2.1 billion to €44.9 billion and by €0.2 billion to €16.0 billion, respectively, over the same period.

The April-May 2013 maintenance period was characterised by a perceptible period-on-period decline in the outstanding liquidity-providing tender volume by around €44 billion to €863 billion on average over the period. Of this, €33 billion was accounted for by longer-term refinancing operations (LTROs), which declined primarily because funds allotted in three-year tenders were repaid. Excess liquidity amounted to around €332 billion on average over the period, and was evident in recourse to the deposit facility of, on average, €115 billion and in the excess reserves held by commercial banks in central bank current accounts, which reached €217 billion. Thus, credit institutions held, on average, 65% of their excess

Factors determining bank liquidity[1]

€ billion; changes in the daily averages of the reserve maintenance periods vis-à-vis the previous period

Item	2013		
	10 Apr to 7 May	8 May to 11 June	12 June to 9 July
I Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors			
1 Banknotes in circulation (increase: –)	– 7.9	– 7.0	– 5.2
2 Government deposits with the Eurosystem (increase: –)	+ 7.2	– 0.6	– 9.4
3 Net foreign assets[2]	+ 0.5	– 1.3	– 40.1
4 Other factors[2]	+ 2.5	– 6.1	+ 57.2
Total	+ 2.3	– 15.0	+ 2.5
II Monetary policy operations of the Eurosystem			
1 Open market operations			
(a) Main refinancing operations	– 10.7	– 8.3	+ 4.1
(b) Longer-term refinancing operations	– 33.0	– 21.5	– 20.4
(c) Other operations	– 2.2	– 0.9	+ 0.9
2 Standing facilities			
(a) Marginal lending facility	+ 0.4	– 0.4	+ 0.8
(b) Deposit facility (increase: –)	+ 19.3	+ 24.0	– 1.6
Total	– 26.2	– 7.1	– 16.2
III Change in credit institutions' current accounts (I + II)	– 23.8	– 21.9	– 13.8
IV Change in the minimum reserve requirement (increase: –)	+ 0.0	– 0.4	+ 0.2

1 For longer-term trends and the Deutsche Bundesbank's contribution, see pp 14• and 15• of the Statistical Section of this Monthly Report. **2** Including end-of-quarter liquidity-neutral valuation adjustments.

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liquidity on central bank current accounts and 35% in the deposit facility, with current account holdings higher than average at the beginning of the period and falling almost constantly over the course of the maintenance period. Banks also engaged in this kind of frontloading in the other two maintenance periods. Over the June-July maintenance period, EONIA averaged 0.08%, 67 basis points below the main refinancing rate (previous period: 68 basis points). There were some deviations, with EONIA slightly higher at the end of the month and the benchmark rate falling at the end of the maintenance period. At around €21 billion on average, EONIA volumes were low and remained virtually unchanged compared with the previous period. Secured overnight money on Eurex Repo's GC Pooling (ECB basket) was traded at an even lower rate of, on average, 0.045%, with average turnovers of €10.8 billion.

The new main refinancing rate of 0.50% was applied for the first time in the May-June 2013 maintenance period. Excess liquidity fell by €46 billion to €286 billion over the period, a somewhat sharper decline than in the previous maintenance period (-€43 billion). The generous, albeit further reduced, liquidity supply was still mainly reflected in high excess reserves. The average volume of the main refinancing operations (MROs) and LTROs amounted to €833 billion, down roughly €30 billion on the previous period. Overnight rates remained fairly stable, averaging 0.08% over the period for EONIA and 0.05% for Overnight GC Pooling, ECB basket. EONIA volumes fell by €3.5 billion to €17.5 billion on average during the maintenance period. By contrast, GC Pooling overnight turnover remained unchanged from the previous period.

In addition to increasing on the previous maintenance period, autonomous factors also became more volatile in the June-July 2013 period. They moved in a range between €472 billion and €526 billion, with

Open market operations of the Eurosystem*

Value date	Type of transaction[1]	Maturity in days	Actual allotment in € billion	Deviation from the benchmark in € billion[2]	Marginal rate/fixed rate %	Allotment ratio %	Weighted rate %	Cover ratio[3]	Number of bidders
10.04.2013	MRO (FRT)	7	119.3	115.3	0.75	100.00	–	1.00	70
10.04.2013	FTO (–)	7	– 206.0	–	0.06	12.88	0.04	1.40	91
10.04.2013	S-LTRO (FRT)	28	5.2	–	0.75	100.00	–	1.00	17
17.04.2013	MRO (FRT)	7	116.4	117.9	0.75	100.00	–	1.00	70
17.04.2013	FTO (–)	7	– 206.0	–	0.05	89.91	0.04	1.28	82
24.04.2013	MRO (FRT)	8	110.4	78.9	0.75	100.00	–	1.00	71
24.04.2013	FTO (–)	8	– 202.5	–	0.14	87.30	0.05	1.25	77
25.04.2013	LTRO (FRT)	98	3.0	–	[4] 0.53	100.00	–	1.00	40
02.05.2013	MRO (FRT)	6	105.0	46.5	0.75	100.00	–	1.00	70
02.05.2013	FTO (–)	6	– 202.5	–	0.10	16.73	0.05	1.26	79
08.05.2013	MRO (FRT)	7	110.3	99.8	0.50	100.00	–	1.00	65
08.05.2013	FTO (–)	7	– 201.0	–	0.08	32.37	0.05	1.33	95
08.05.2013	S-LTRO (FRT)	35	5.2	–	0.50	100.00	–	1.00	17
15.05.2013	MRO (FRT)	7	103.8	108.8	0.50	100.00	–	1.00	64
15.05.2013	FTO (–)	7	– 201.0	–	0.08	19.60	0.05	1.24	95
22.05.2013	MRO (FRT)	7	103.4	66.9	0.50	100.00	–	1.00	62
22.05.2013	FTO (–)	7	– 201.0	–	0.08	93.15	0.06	1.26	96
29.05.2013	MRO (FRT)	7	103.2	16.7	0.50	100.00	–	1.00	63
29.05.2013	FTO (–)	7	– 197.0	–	0.15	12.93	0.07	1.19	89
30.05.2013	LTRO (FRT)	91	5.8	–	[4] …	100.00	–	1.00	36
05.06.2013	MRO (FRT)	7	103.0	– 3.5	0.50	100.00	–	1.00	70
05.06.2013	FTO (–)	7	– 197.0	–	0.09	89.67	0.07	1.40	106
12.06.2013	MRO (FRT)	7	108.3	72.3	0.50	100.00	–	1.00	70
12.06.2013	S-LTRO (FRT)	28	3.6	–	0.50	100.00	–	1.00	20
12.06.2013	FTO (–)	7	– 195.0	–	0.08	63.51	0.07	1.43	101
19.06.2013	MRO (FRT)	7	102.0	99.5	0.50	100.00	–	1.00	73
19.06.2013	FTO (–)	7	– 195.0	–	0.08	64.49	0.07	1.29	102
26.06.2013	MRO (FRT)	7	117.3	65.8	0.50	100.00	–	1.00	99
26.06.2013	FTO (–)	7	– 195.0	–	0.45	28.63	0.18	1.10	83
27.06.2013	LTRO (FRT)	91	9.5	–	[4] …	100.00	–	1.00	50
03.07.2013	MRO (FRT)	7	107.7	64.2	0.50	100.00	–	1.00	78
03.07.2013	FTO (–)	7	– 195.0	–	0.13	41.26	0.09	1.23	91

* For more information on the Eurosystem's operations from 16 January 2013 to 9 April 2013, see Deutsche Bundesbank, Monthly Report, May 2013, p 23. **1** MRO: main refinancing operation, LTRO: longer-term refinancing operation, S-LTRO: supplementary longer-term refinancing operation, FTO: fine-tuning operation (+: liquidity providing operation, –: liquidity absorbing operation), FRT: fixed-rate tender. **2** Calculation according to publication after MRO allotment. **3** Ratio of total bids to the allotment amount. **4** The interest rate corresponds to the average minimum bid rate or main refinancing rate of the MROs conducted over the life of this operation (may be rounded to two decimal places in the table).

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general government deposits being the main contributor to the volatility. The June-July period was also characterised by greater recourse to the marginal lending facility of up to €6.5 billion between 19 and 25 June 2013. This was the result of a collateral-related, temporary shift from the main refinancing operations to the marginal lending facility. The willingness to repay three-year tenders fell over the observation period and meant that the outstanding volume from liquidity-providing tender operations did not change as much as in the two previous maintenance periods, standing at around €817 billion on average over the period. Main refinancing operations contributed an average of 13% to this total, unchanged from the previous two maintenance periods. With average excess liquidity down €12 billion to €274 billion, EONIA continued to average 0.08% in this maintenance period (excluding the last day of the first half year, for which the benchmark rate exhibited a typical pattern, increasing by 12 basis points). The difference between the average EONIA rate and the GC Pooling secured overnight rate narrowed from 3 basis points in the previous period to 2 basis points in the June-July maintenance period due to the slight upward tendency in secured overnight money; this suggests that the secured rate reacted more strongly to the fall in excess liquidity.

Consolidated balance sheet of the MFI sector in the euro area*

Changes in € billion, seasonally adjusted

Assets	2013 Q2	2013 Q1	Liabilities	2013 Q2	2013 Q1
Credit to private non-MFIs in the euro area	– 91.9	12.1	Central government deposits	11.5	– 6.3
Loans[1]	– 99.5	0.5	Monetary aggregate M3	4.7	50.8
Securities	15.5	17.4	*of which:* Components		
			Currency in circulation and overnight deposits (M1)	53.5	95.3
Credit to general government in the euro area	23.2	24.6	Other shorter-term bank deposits (M2-M1)	– 18.2	0.5
Loans	– 35.5	– 20.1	Marketable instruments (M3-M2)	– 30.6	– 44.9
Securities	58.8	44.7			
Net external assets	89.1	63.8	Monetary capital	– 31.3	2.5
Other counterparts of M3	– 43.5	– 59.3	*of which*		
			Capital and reserves	36.4	54.0
			Other longer-term financial liabilities	– 67.7	– 51.5

* Adjusted for statistical changes. **1** Adjusted for loan sales and securitisation.
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Short-term money market rates have, on average, been marginally above the levels of the first quarter of 2013 since April despite key ECB interest rates being lowered on 2 May 2013. This is because the short end of the euro area's money market yield curve is currently shaped in particular by the unchanged deposit rate and the still high – yet declining – excess liquidity. Above all, money market forward rates,[1] which reflect market expectations on the future development of money market rates, witnessed a rising trend and greater fluctuations from May. These developments essentially reflect clear changes at the long end of the yield curve in the major currency areas, which must be seen *inter alia* in the context of changing expectations regarding further prospects of unconventional monetary policy measures of major central banks around the world.

Like their US counterparts, euro-area money market forward rates briefly peaked in the second half of June but declined again considerably – in parallel with the corresponding US rates – at the end of June. In response to the ECB Governing Council's forward guidance, the sharp decline in European forward rates was temporarily even more considerable. However, a sustainable decoupling from the development of US forward rates has not yet taken place, which is also to be seen against the backdrop of the recent improvement in leading economic indicators for the euro area.

Monetary developments in the euro area

Macroeconomic setting

As in the preceding quarters, the main factors influencing euro-area monetary dynamics in the second quarter of 2013 were the economic situation and, above all, inflows from abroad and the interest rate constellation. Given the low opportunity cost of holding money and the relatively low level of attractiveness of longer-term investments, overnight deposits kept growing considerably in the reporting quarter and – coupled with the renewed increase in non-residents' willingness to transfer funds to the euro area – fuelled growth of M3. However, the factors supporting M3 growth were increasingly dominated by growing cutbacks in loans to the private sector as a result of weak macroeconomic developments.

Monetary developments subdued

Against this backdrop, the second quarter of 2013, too, was characterised by an – albeit only slight – expansion of M3 alongside con-

1 Implicit forward rates derived from swap rates for the unsecured interbank overnight rate EONIA and interest rates of exchange-traded futures on three-month Euribor.

tracting volumes of loans to the domestic private sector. The renewed flattening of the yield curve continued to stimulate substantial outflows of non-overnight deposits included in M3. Monetary capital, which had been recording outflows almost continuously since the beginning of 2012, posted yet another decline. However, in contrast to the previous quarters, overnight deposits benefited less from investors' portfolio shifts in the spring quarter, which had the effect that M3 growth, too, weakened: the sustained increase in money supply since the beginning of 2010, which had already lost a great deal of momentum at the beginning of 2013, was therefore yet again markedly weaker in the reporting quarter. However, the annual growth rate dropped only slightly to 2.3%.

Decline in lending to the private sector, …

The annual growth rate of lending to the private sector (adjusted for loan sales and securitisation) slid even deeper into negative territory and stood at -1.0% at the end of the second quarter of 2013. This meant that, although the annualised rates of monetary and credit growth were moving in the same direction, they did not converge.[2]

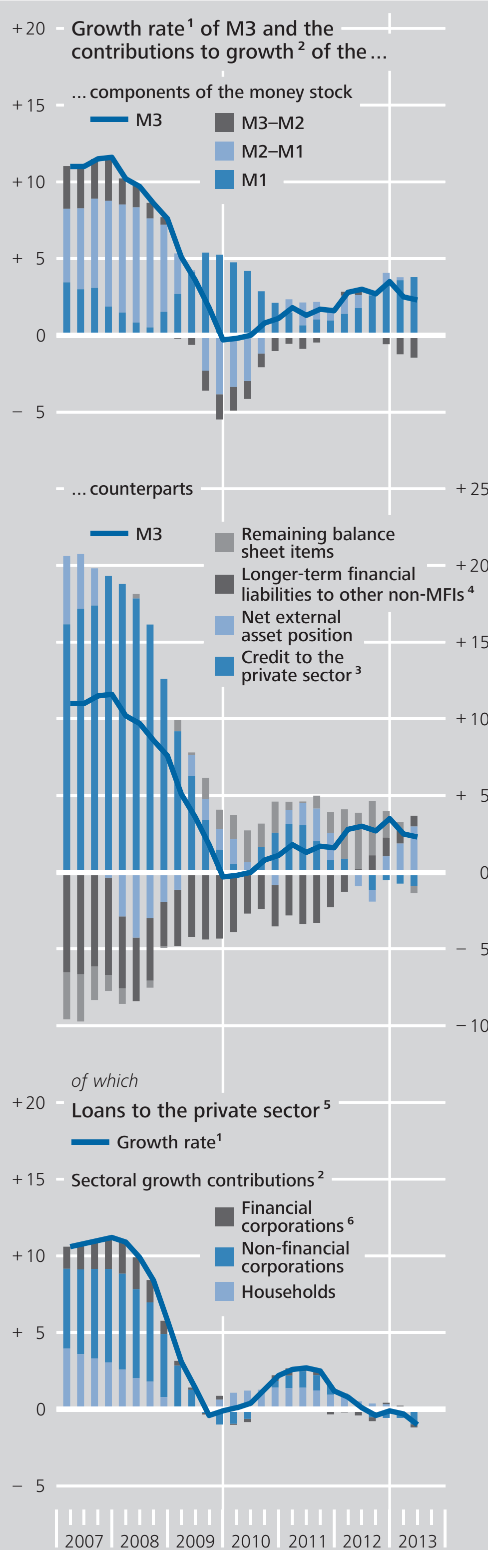
… amidst heterogeneous developments in the euro area

The substantial decline in loans in the euro area was, above all, a reflection of the still weak economic situation and the persistently great need for deleveraging in the euro-area peripheral countries. Spain in particular recorded a strong reduction in lending to the private sector, although loans in the other peripheral countries were down, too. Moreover, banks in the euro-area core countries posted a lower level of growth in lending business than one quarter earlier.

Net redemptions mainly affected the non-financial private sector, and there almost exclusively lending to non-financial corporations,

Components and counterparts of the money stock in the euro area

Seasonally adjusted, end-of-quarter data



1 Year-on-year change in per cent. **2** In percentage points. **3** Adjusted for loan sales and securitisation. **4** Taken in isolation, an increase curbs M3 growth. **5** Adjusted for loan sales and securitisation from 2010 Q1. **6** Non-monetary financial corporations.

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2 For an in-depth analysis of the heterogeneous developments of money and credit growth in the euro area, see Deutsche Bundesbank, Differences in money and credit growth in the euro area and in individual euro-area countries, Monthly Report, July 2013, p 47ff.

Substantial net redemptions among non-financial corporations

which declined especially in the peripheral countries – though also in Germany. Added to this was the fact that non-financial corporations in some euro-area countries have substituted loans in part with market financing or by making greater use of internal funding (see box on pages 42 to 43).

According to BLS, slight tightening of standards and marked decline in demand

This is consistent with the banks interviewed in the second quarter of 2013 as part of the Bank Lending Survey (BLS) reporting a marked decline in demand for bank loans. Although bank-imposed constraints cannot be ruled out, the results of the latest survey round do not attribute great importance to them with regard to the weak credit developments in the euro area: the majority of countries did not adjust their credit standards at all and the remaining countries tightened them only moderately in most cases. The main reason for these adjustments, according to the institutions surveyed, was the deterioration in the perception of risks regarding the business cycle and borrowers. With regard to their funding options, the banks yet again reported improvements in most of the surveyed sub-markets and indicated that the sovereign debt crisis continued to have no marked impact on their funding conditions and lending policies. However, the surveyed banks stated that the introduction of stricter capital requirements had prompted them to reduce their risk-weighted assets.

Moderate decline in lending to households

The economic situation and the continued need for deleveraging in some countries were also reflected in net redemptions in loans to households. Although these were extremely moderate in absolute terms, it is striking that loans for house purchase, which had supported lending to households on the whole, did not this time offset the further decline in consumer loans and other credit. This, too, is evidence of the heterogeneous developments between euro-area core countries and peripheral countries: while housing loans receded discernibly in particular as a result of the need to reduce the high level of indebtedness in Spain, but also in the other peripheral countries, they continued to grow moderately in Germany and France, probably not least as a result of the persistently low interest rate level.

Continued expansion in credit to general government supports money growth along with …

The substantial reduction in credit to the private sector was countered by a moderate expansion in lending by euro-area MFIs to general government. Italy and Spain in particular saw demand focussed mainly on securities of their domestic public sectors. By contrast, loans to general government experienced net redemptions. This development was observed almost throughout all euro-area countries. However, it was particularly pronounced in Spain, where current shifts from loans to securities must also be regarded as a counter-movement to the preceding opposite substitution, which was triggered by market access being made more difficult for the public sector.

… another considerable rise in the net external asset position

The largest contribution to money growth was made – as in the past three quarters – by net claims of the banking sector on non-residents. As in the past, the renewed increase was driven by both sustained current account surpluses and additional net capital inflows in portfolio investment from abroad. Although euro area investors, too, increasingly acquired foreign securities, which had a dampening effect on the banking sector's net external assets, this was outweighed by the persistently extensive purchases of securities by investors outside the euro area. This is probably also attributable to the reversal of capital outflows seen up until mid-2012 due to the high level of uncertainty regarding further euro-area developments.

Money-based forecasts with balanced inflation risks

Overall, the analysis of money and its counterparts suggests that underlying inflation-relevant monetary growth remains subdued. On average, inflation forecasts based on various monetary indicators (monetary aggregates, short-term deposits, loans) also currently signal balanced risks for price stability over the next three years. However, the uncertainty associated with these forecasts remains high.

German banks' deposit and lending business with domestic customers

Increase in deposits driven primarily by overnight deposits, …

Against the backdrop of historically low interest rate levels and the flat yield curve, the reduction of long-term deposits and riskier other assets in favour of more liquid deposits continued in Germany in the second quarter of 2013. Hence, developments in Germany did not contribute to the slow-down in growth of deposits included in M3 that was observed in the euro area. Given their high flexibility and the narrow interest rate spread on other investment forms, it was once again overnight deposits that benefited most. The fact that their share of all German deposits included in M3 has continuously risen in the last five years from 29½% to just over 43½% reflects currently very liquid money holdings in Germany.

… especially owing to portfolio shifts of households

Particularly the declining risk aversion observed in European financial markets since the beginning of the year has not yet had a dampening effect on German investors' build-up of deposits. Most of the inflow of short-term deposits stemmed from households; their usually rather interest rate-induced shifts even regained momentum in the last two quarters. However, the corporate sector showed no signs of a shift in investment behaviour either. Over the last few quarters, the currently cash-rich non-financial corporations have not altered the pace with which they accumulate short-term deposits. At the same time, insurance companies and pension funds continued to reduce their long-term time deposits and invest the funds that were freed up in investment forms outside the monetary aggregates.

Lending to non-financial corporations recedes substantially

German lending business stagnated in the reporting quarter and therefore did not offset the reduction in lending in the rest of the euro area. This was mainly the result of a steep fall in loans to non-financial corporations, especially in the short-term but also in the medium-term maturity segment. Given that the development in loans to non-financial corporations typically lags behind both macroeconomic developments and investment by around three quarters,[3] most of the decline in loans to enterprises can be explained by the phase of weak economic growth towards the end of 2012 and subdued investment by German enterprises. It therefore remains to be seen in the quarters ahead whether the German enterprises' propensity to invest continues to be weighed down by the gloomy outlook for European sales markets and the uncertainty induced by the euro-area debt crises. Moreover, the rise in non-financial corporations' internal funding and their recourse to alternative forms of external financing – such as the issuance of debt securities – made a discernible contribution to the net redemptions of loans to enterprises (see box on pages 42 to 43). The results of the BLS from the second quarter of 2013 are in line

Lending and deposits of monetary financial institutions (MFIs) in Germany*

Changes in € billion, seasonally adjusted

Item	2013 Q1	2013 Q2
Deposits of domestic non-MFIs[1]		
Overnight	38.2	30.1
With agreed maturities		
of up to 2 years	– 0.9	– 11.8
of over 2 years	– 5.7	– 7.0
Redeemable at notice		
of up to 3 months	– 1.3	4.8
of over 3 months	– 3.9	– 3.8
Lending		
to domestic general government		
Loans	– 3.8	– 3.7
Securitised lending	– 5.7	– 4.2
to domestic enterprises and households		
Loans[2]	2.3	– 1.8
of which to households[3]	4.2	3.6
to non-financial corporations[4]	0.5	– 5.2
Securitised lending	– 1.8	6.2

* As well as banks (including building and loan associations, but excluding the Bundesbank), monetary financial institutions (MFIs) here also include money market funds. End-of-quarter data, adjusted for statistical changes. **1** Enterprises, households and general government excluding central government. **2** Adjusted for loan sales and securitisation. **3** Including non-profit institutions serving households. **4** Corporations and quasi-corporations.

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3 See Deutsche Bundesbank, German banks' lending to the domestic private sector since summer 2009, Monthly Report, September 2011, p 64 ff.

Statistical focus on insurance corporations and pension funds

In the wake of the financial crisis, domestic insurers are facing challenges with considerable economic ramifications. Against this background, the Deutsche Bundesbank is making available additional information on the insurance sector, for instance by including for the first time tables containing data on the assets and liabilities of insurance corporations and pension funds resident in Germany in the Statistical Section of the *Monthly Report* (Tables VII 1 and 2).

The balance sheet data compiled underscore the significance of insurance corporations and pension funds in their function as financial intermediaries. With an aggregate balance sheet total of more than €2 trillion at the end of 2012, the insurance sector plays a key role in the accumulation and routing of long-term funding, in particular. Two-thirds of these funds stem from savings accumulated by households with life insurers and pension funds. Insurance corporations place this capital principally in deposits with monetary financial institutions (often in the form of borrower's note loans), or in debt securities and investment fund shares/units (comprising mostly debt securities) and, in so doing, provide the issuing banks, enterprises and general government with – for the most part long-term – capital.

The sustained low interest rate environment poses a particular challenge for the insurance industry. For one thing, long-term financial investments in the form of endowment policies are losing their appeal. For another, insurance corporations are searching for alternative investment opportunities beyond the scope of traditional long-term maturity debt securities. Up to now, the growth in balance sheet assets and liabilities has primarily reflected the valuation effect of declining interest rates. The question of whether there will also be strong volume effects and how durable these may be will require careful analysis. In this regard, the additional statistics provided in the *Monthly Report* will create a valuable source of information.

The Bundesbank is compiling the data on the assets and liabilities of insurance corporations and pension funds contained in the new statistical tables as a preliminary to the ESCB's planned introduction of harmonised European insurance statistics. As the data meet the methodological requirements of the European System of Accounts (ESA), they are, in principle, comparable with national account figures, especially the financial accounts. The source data used in the Bundesbank calculations are derived for the most part from insurance supervisors.

The intention is to broaden the data base in collaboration with insurance supervisors over the coming years. This work will focus particularly on the more detailed capture of portfolio investment on a security-by-security basis. Furthermore, in view of the future supervisory standard Solvency II, the statistical coverage of insurance groups will become ever more important.

with the above: the participating institutions indicated that enterprises' demand for loans had dropped markedly because they were making use of other financing sources.

Marked increase in lending to households

The fact that – despite the major reduction in loans to non-financial corporations – loans to the German private sector declined only slightly on balance in the reporting quarter is due to the distinct rise in lending to households. A decisive factor in this was – as in the previous quarters – the demand for private housing loans, which is being driven not only by favourable financing conditions but also, at present, by uncertainty-induced portfolio shifts into tangible assets. The BLS results, too, confirm that the rise in demand for private housing loans observed since the spring of 2010 continued in the second quarter of 2013 – albeit in a less pronounced manner. According to the surveyed bank managers, the main reason for this development was that households continued to have a positive outlook on the housing market.

Loans of German banks to selected sectors

Seasonally adjusted and adjusted for loan sales and securitisation, end-of-quarter data

1 Year-on-year rate of change. 2 Non-monetary financial corporations. 3 Non-financial corporations and quasi-corporations.
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In addition, improved income prospects and reduced job uncertainty in Germany were reflected in an – albeit only slight – increase in consumer loans. Correspondingly, the banks surveyed as part of the BLS reported a distinct increase in the demand for consumer loans for the first time in around two years. Overall, however, lending to households in the second quarter can still be regarded as moderate: the annual growth rate of loans to domestic households was low, remaining unchanged at 1.2%; the absence of a faster pace of growth of late was also found in the case of private housing loans, the annual growth rate of which stood at 2.1% at the end of June.

German banks' credit standards for enterprises unchanged

On the supply side, the weak growth in domestic lending to the private sector was matched by merely a slight change in lending policies on the whole. The German results of the BLS indicate that the surveyed institutions did not on balance adjust their standards for loans to enterprises in the second quarter of 2013. Thus, the period of little overall change in lending policies, which has lasted for four years now, continued. The balanced result in the past quarter is the outcome of two opposing effects: on the one hand, banks' equity costs were slightly higher and on the other hand, the increased competition between the institutions had the effect of slightly relaxing credit standards. By contrast, cyclical and industry or firm-specific factors per se had no impact. At the same time, the surveyed banks moderately widened their margins for loans to enterprises.

Credit standards vis-à-vis households virtually unchanged

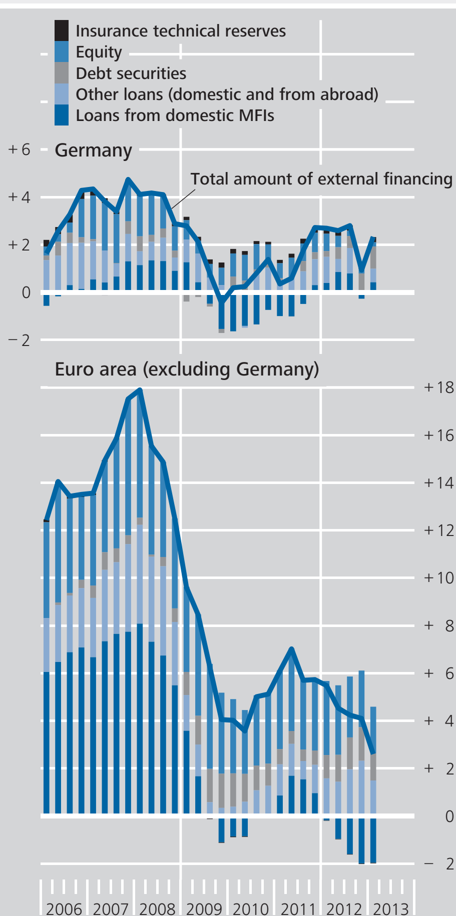
Lending practices for loans to households did not change a great deal either. The standards for housing loans were tightened moderately given the surveyed banks' pessimistic assessment of the outlook on the housing market – unlike the outlook of households, which in the bank managers' opinion do not expect any deterioration. However, the margins in this credit segment remained constant. The surveyed banks left the standards for consumer loans

The structure of corporate financing amid weak loan growth in Germany and the euro area

According to data from the financial accounts, the overall financing volume of non-financial corporations in Germany picked up again noticeably in the first quarter of 2013 following rather weak growth towards the end of 2012.[1] The quite high and stable level of internal financing, which has been a typical feature of the German corporate landscape for years, was accompanied by a surge in external financing. There was a particular increase in capital market financing: by issuing bonds, non-financial corporations managed to procure funds which, in nominal terms, matched levels last seen about ten years ago. Loans granted by German and foreign non-MFIs (especially by other non-financial corporations in the (inter)national corporate network as well as by other financial institutions and insurers), which had seen net reductions at the end of 2012, also bounced back to a marked degree. By contrast, lending by domestic MFIs experienced less dynamic growth. Moreover, share issuance played no more than a minor role during the first quarter of 2013.

Structure of external financing* of non-financial corporations

As a percentage of GDP; moving sum of the four preceding quarters



Source: ECB and Bundesbank calculations. * External financing excluding other liabilities.

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Overall, these financial accounts figures for the first quarter serve to underline the trend towards a growing substitution of domestic bank loans by other forms of financing and recourse to alternative lenders, which has been observable for several years in the corporate sector. In particular, there has been a shift to intra-group loans and capital market-based funding, as well as trade credits.[2] This trend decline in the significance of MFI loans as a source of external financing is probably due not just to the growing competition from non-MFI lenders but also to efforts by borrowers to diversify their funding options so as to be less vulnerable to developments in individual market segments in the future. At times, bank-imposed restrictions are likely to have contributed to

1 The financial accounts figures usually become available with a time lag of just more than one quarter. Consequently, the results for the first quarter of 2013 represent the situation at the current end. The delay is due to the large number of incoming primary sources and the associated complexity of the calculations.
2 It is not possible to derive from the aggregated data the extent to which this observation applies to all branches and firm sizes.

the declining popularity of MFI loans, not least in 2009.[3] At present, however, these factors are proving of negligible importance in Germany.

The picture is somewhat different for external financing in the euro area as a whole (excluding Germany). Here, too, the past few quarters have seen adjustments which have induced a distinct increase in financing via non-MFI loans and the issuance of securities (in particular unquoted shares and debt securities).[4] Nevertheless, the extent of these substitution effects was much less pronounced, causing the cutback in loans to lead to an overall decline in debt. This has to be seen, above all, against the backdrop of the continued need for non-financial corporations to deleverage and of the weak macroeconomic environment. On top of this, a more restrictive approach to lending by banks has, at times, also impacted on loan growth in the euro area. Despite poor turnover results, it has also been possible to boost internal financing significantly since 2009 thanks to increased cost savings.

3 The temporary tightening of credit standards in economic downturns as well as more stringent regulatory requirements are likely to play a role in this development. See Deutsche Bundesbank, Long-term developments in corporate financing in Germany – evidence based on the financial accounts, Monthly Report, January 2012, pp 13-27, and B Blaes, Bank-related loan supply factors during the crisis: an analysis based on the German bank lending survey, Deutsche Bundesbank Discussion Paper, Series 1, No 31/2011.
4 For a detailed country-specific analysis, see Task Force Eurosystem, Structural Issues Report 2013, Corporate Finance and Economic Activity in the Euro Area, ECB Occasional Paper, No 151.

largely unchanged on balance and even adjusted their margins somewhat in favour of their borrowers.

Sovereign debt crisis alone has no impact on lending policies

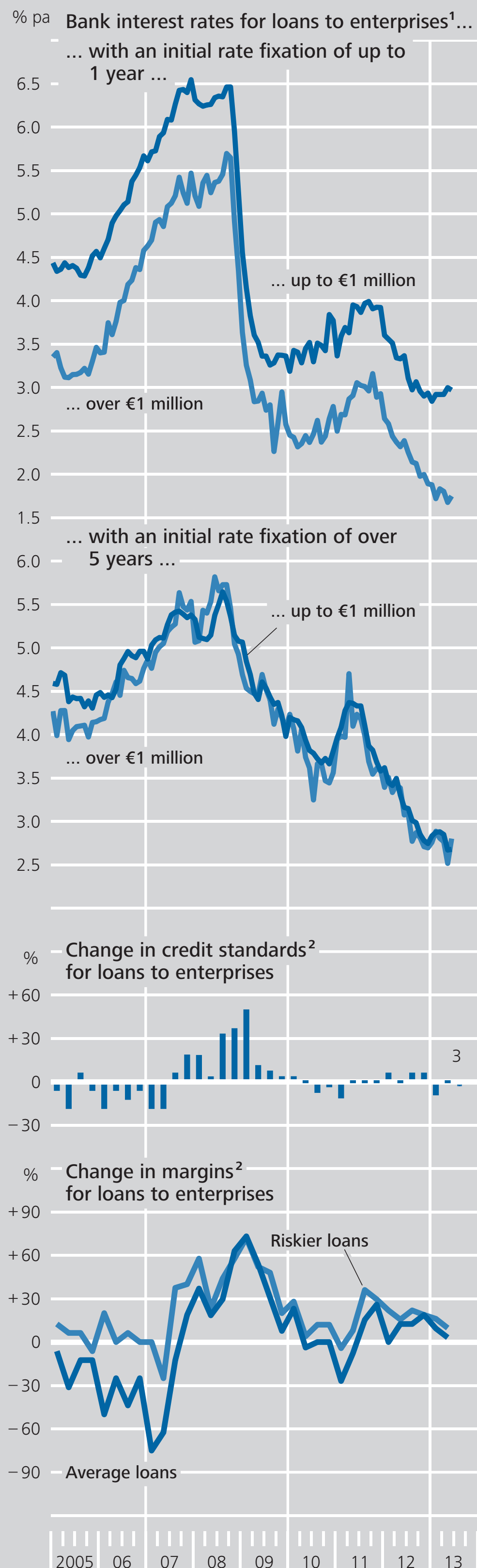
In the second quarter, the survey contained ad hoc questions on the impact of the financial and sovereign debt crisis on banks' funding conditions and credit standards as well as on the more stringent capital requirements. As in the two preceding quarters, the surveyed institutions reported a slight overall improvement of the funding environment and stated that the sovereign debt crisis was still not having any impact on their lending policies. German banks scaled back their risk-weighted assets in the first half of 2013 in preparation for the stricter capital requirements pursuant to CRR / CRD IV, and strengthened their capital position primarily by retaining profits. Taken in isolation, the new capital requirements in lending business were reflected in tighter credit standards and higher margins – especially in the case of loans to large enterprises.

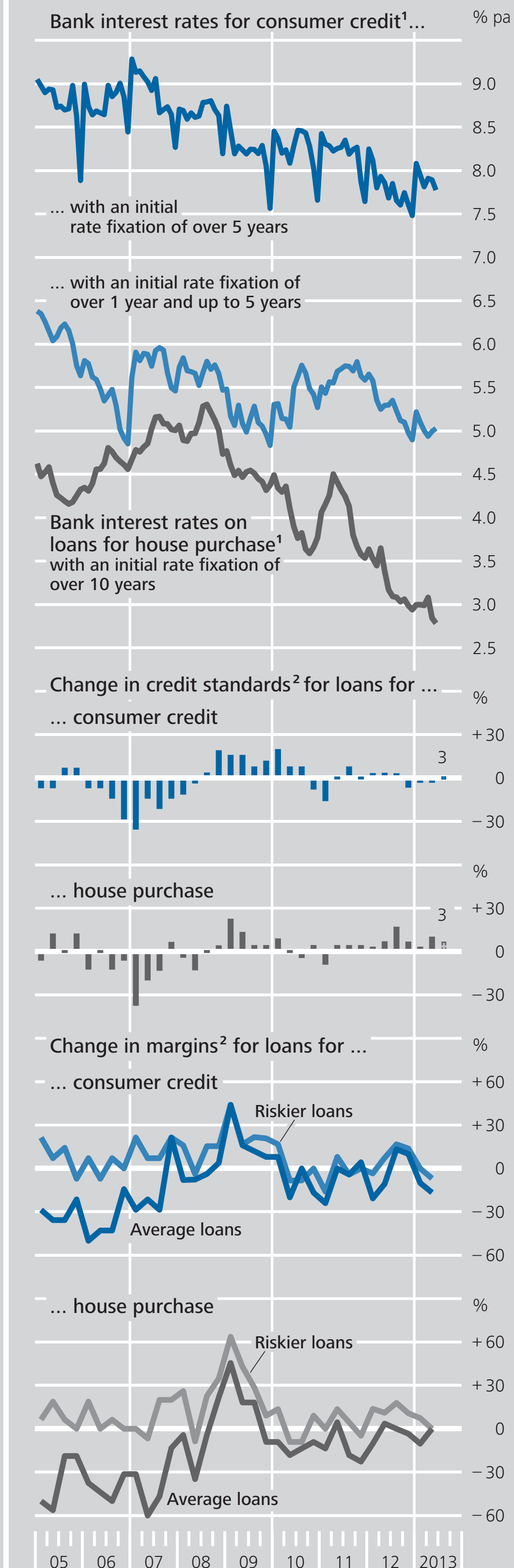
Bank lending rates do not follow interest rate hike in the capital market

Bank lending rates on new loans are likely to have had on the whole a supporting effect on domestic lending to the private sector. Whereas interest rates in the capital markets moved moderately upwards again, bank lending rates either stagnated or receded at a low level across all the relevant business areas, maturities and volumes in the second quarter. With regard to loans to enterprises, interest rate changes were predominantly relatively negligible, but mixed. The reporting institutions were charging interest for short-term funds of 3.0% for small-scale and 1.7% for large-scale loans of late. The interest rates on long-term loans to domestic non-financial corporations stood at 2.7% and 2.8% respectively.

Unlike the heterogeneous developments in interest rates on loans to enterprises, housing loans of virtually all maturities were around 20 basis points lower than one quarter earlier. For instance, interest rates on long-term loans for house purchase dropped to a new historical

Banking conditions in Germany





1 New business. According to harmonised MFI interest rate statistics. **2** According to the Bank Lending Survey, difference between the number of respondents reporting "tightened considerably" and "tightened slightly" and the number of respondents reporting "eased somewhat" and "eased considerably" as a percentage of the responses given. **3** Expectations for 2013 Q3.

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low and amounted to a mere 2.8% of late. Once again, deposits of households and non-financial corporations, too, almost consistently earned less interest compared with the previous quarter.