Monetary developments

Money market management and central bank money requirements

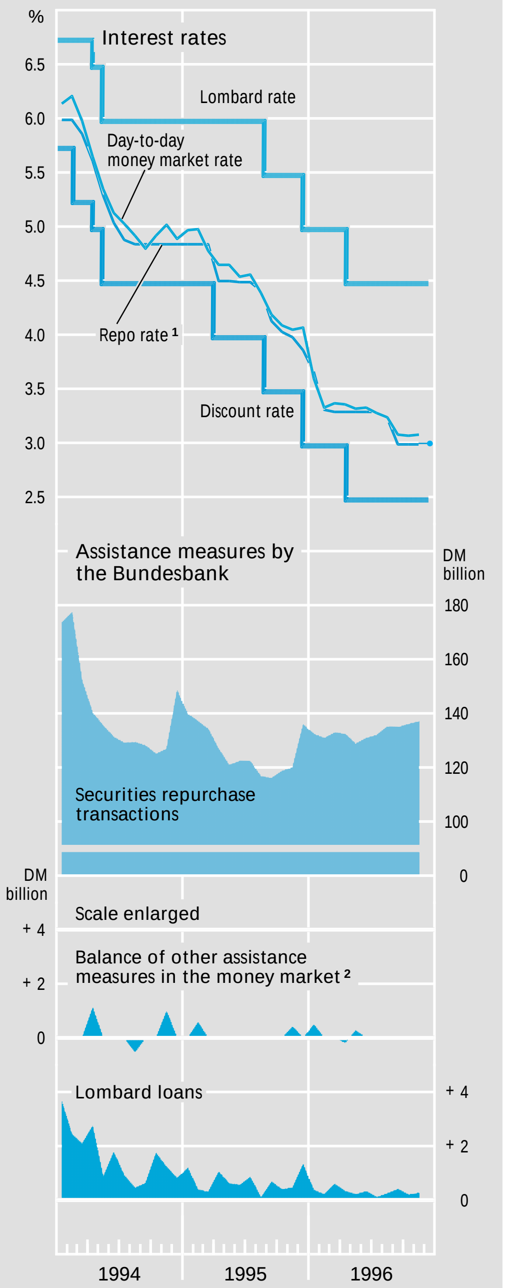
"Steady-as-she-goes" policy in the money market

After reducing its interest rates to an all-time low in some cases during the previous course of the year, the Bundesbank left them unchanged in the autumn months; the discount and lombard rates remained at the level of 2.5 % and 4.5 %, respectively, to which they were last lowered in April 1996, and securities repurchase agreements continued to be offered in the form of fixed-rate tenders at the rate of 3.0 %, which has applied since the end of August. The Central Bank Council gave additional guidance to the market by the consistent advance announcement immediately after its meetings of the (unchanged) terms for the securities repurchase agreements to be concluded in the following weeks. The central bank rates seem to be in line with overall economic conditions. A "steady-as-she-goes" approach in interest rate policy was also suggested by the fact that there has been a slight increase in the growth of the money stock recently.

Money market rates

Owing to the fact that the Bundesbank's policy was geared towards stabilising interest rates, money market rates remained largely unchanged in the autumn months. The price for day-to-day money was close to the repurchase rate in nearly all cases. There was scarcely any movement in the short and medium-term time deposit rates. At the end of November, however, the rate for one-month funds increased perceptibly owing to "end-of-year premiums". Influenced by the decline in interest rates in the capital market, the price for one-year funds fell slightly at first

Operating variables in the money market



1 Average monthly interest rate for securities repurchase transactions with two-week maturities, uniform allotment rate (fixed-rate tenders) or marginal allotment rate (variable-rate tenders). — 2 Quick tenders, foreign exchange swap and repurchase transactions and short-term Treasury bill sales. — • = Latest position: Dec. 11, 1996.

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before regaining its former level of late. On balance, the yield curve in the money market remained very flat. Rates for interest rate futures, which reflect interest rate expectations in the market even more clearly, also remained fairly stable in the past few months. By international standards, the rates in the Deutsche Mark money market continue to be rather low. At the same time, there was a further narrowing of the international interest rate range as a result of continued steps to ease conditions in the majority of neighbouring countries with higher interest rates.

Money market management through repurchase agreements

The Bundesbank's ongoing money market management was quite free of tensions in the autumn months and was largely able to confine itself to the regular weekly conclusion of securities repurchase transactions running for two weeks. In the period under review, the Bundesbank's provision of liquidity remained geared to keeping credit institutions' daily central bank balances closely in line with reserve requirements throughout the month, thus enabling credit institutions to fulfil minimum reserve requirements consistently. Only at the beginning of October did credit institutions' provision with liquidity run short, when there was an extremely sharp rise in currency in circulation in connection with the Day of German Unity public holiday; nevertheless, the slight increase in the price for day-to-day money was only temporary. The setting of repurchase agreements, which was on the whole in line with demand, is also reflected by the low level of lombard borrowing, which was below DM 0.1 billion on almost every day throughout the months under review. It was only at the end of each month that banks stepped up their recourse to lombard borrowing under their concluding minimum reserve operations. In November lombard borrowing was concentrated on the last business day but one, as credit institutions were thus able to avoid major withdrawals which, owing to the pattern of working days and the following weekend, would otherwise have had an "overhang" effect into the month of December.

Fine-tuning measures

The Bundesbank applied no short-term fine-tuning measures between September and November. However, at the beginning of December, when a temporary greater need of funds became discernible, it provided additional liquidity in the run-up to the first regular tender date by concluding two-day foreign exchange swap transactions, thereby exerting a steadying influence on movements in the market for day-to-day money.

Slight rise in the central bank money requirement

Trends in the principal factors determining liquidity between September and November are shown in detail in the adjacent table. The rise of DM 1.7 billion meant that the expansion in the stock of central bank money (currency in circulation in the hands of non-banks and minimum reserves on domestic liabilities at current reserve ratios) was comparatively slight in this period. This is due solely to the fact that the increase in currency in circulation was extremely small, while the required minimum reserves grew on a seasonally typical scale. The demand for currency in circulation slackened markedly, particularly at the end of the period under review, with the result that the seasonally adjusted stock of central bank money declined in absolute terms in November.

Factors determining bank liquidity *

DM billion;
calculated on the basis of daily averages of the months

Item	1996 Sep. to Oct.	Nov. pe	Sep. to Nov. pe
I. Provision (+) or absorption (–) of central bank balances by			
1. Change in central bank money (increase: –)	– 1.2	– 0.5	– 1.7
Currency in circulation	(– 0.9)	(– 0.3)	(– 1.2)
Minimum reserves on domestic liabilities (at current reserve ratios)	(– 0.3)	(– 0.2)	(– 0.5)
Memo item Change in seasonally adjusted central bank money	(+ 1.8)	(– 0.7)	(+ 1.1)
2. Foreign exchange movements (excluding foreign exchange swaps)	+ 3.6	+ 0.8	+ 4.4
3. Other factors	– 2.5	– 1.2	– 3.7
Total	– 0.1	– 1.0	– 1.1
II. Lasting provision (+) or absorption (–) of funds	– 0.8	– 0.0	– 0.8
1. Change in refinancing facilities	(– 0.1)	(– 0.1)	(– 0.2)
2. Recourse to unused refinancing facilities (reduction: +)	(– 0.7)	(+ 0.1)	(– 0.6)
III. Change in the short-term liquidity deficit (I plus II; increase: –)	– 0.9	– 1.0	– 1.9
IV. Meeting of remaining deficit (+) or absorption of surplus (–) by			
1. Securities repurchase transactions	+ 0.9	+ 0.9	+ 1.8
2. Change in lombard loans (increase: +)	– 0.0	+ 0.1	+ 0.0
Memo items 1			
Unused refinancing facilities	3.3	3.2	3.2
Securities repurchase transactions	136.0	136.9	136.9
Balance of very short-term assistance measures 2	–	–	–
Lombard loans	0.2	0.3	0.3

* For longer-term trends see pages 12*/13* in the Statistical Section of this Report. — 1 Levels (in the current month or in the last month of the period). — 2 Quick tenders, foreign exchange swap and repurchase transactions and sales of short-term Treasury bills.

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Current transactions

On balance, credit institutions' current transactions with the Bundesbank slightly increased liquidity in the autumn months. This was due to the Bundesbank's external position, which rose by DM 4.4 billion between September and November. In addition to autonomous foreign exchange inflows (purchases of dollars from US military agencies, in particular), a part in this was played by foreign monetary authorities' withdrawals of their Deutsche Mark balances at the Bundesbank, *inter alia,* in connection with the issuing of Treasury discount paper ("Bubills") in October. Other factors' drain on liquidity, at DM 3.7 billion, was largely consistent with the usual conditions. This mainly reflects the entries to the Bundesbank's profit and loss account as well as items in the course of settlement within the central bank system, the contractionary impact of which was somewhat more marked in the months under review than in the previous period. In addition, banks increased their cash holdings slightly.

In total, credit institutions recorded outflows of funds of DM 1.1 billion net in the autumn months as a result of the change in stocks of central bank money and current transactions. Furthermore, banks reduced their rediscount borrowing by DM 0.8 billion. One reason for this was the gradual phasing out of the existing forms of funding under the special rediscount facilities (ceiling B) granted to the AKA Ausfuhrkredit-Gesellschaft mbH, which were abolished with effect from the end of May 1996. In total, the banks' short-term liquidity gap increased by DM 1.9 billion between September and November. The Bundesbank met the higher shortage almost entirely by increasing the volume of regular securities repurchase transactions (by a monthly average of DM 1.8 billion) to latterly DM 136.9 billion.

Monetary developments

Slightly sharper monetary growth again

Following the slowdown in monetary expansion in the spring, monetary growth has increased again slightly during the past few months; in August and October, in particular, monetary balances grew fairly vigorously. In October the money stock M3[1], after adjustment for seasonal influences, exceeded its average level in the fourth quarter of 1995 by an annual rate of 8.4 %, compared with 8.6 % in July and 12.3 % in March. The money stock thus remained above this year's target corridor of 4 % to 7 %, but has again drawn somewhat closer to its upper limit. It is foreseeable that the monetary target will be overshot at the end of the year, too.

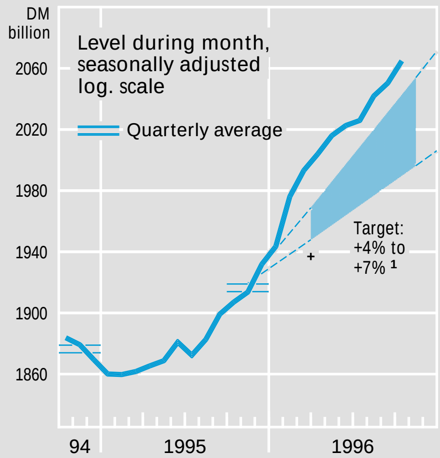
The slight acceleration of monetary expansion after the middle of the year was, on the one hand, caused by a renewed slowdown in monetary capital formation that is likely to have been a consequence, *inter alia,* of reserve liquidity holdings for the purchase of Telekom shares in November. On the other, bank lending to the public sector showed a marked increase in October. After the effects

1 Currency in circulation and the sight deposits, time deposits for less than four years and savings deposits at three months' notice held by domestic non-banks – other than the Federal Government – at domestic credit institutions; calculated as a monthly average.

of these influences subside, monetary growth should decelerate again. Borrowing by the private sector rose slightly between August and October. At the same time, the fairly high inflows of funds arising from non-banks' foreign payment transactions virtually dried up. As in the previous course of the year, purchases of money market fund certificates by domestic non-banks had no significant impact on monetary developments.

Growth of the money stock M3*

Target and movement to date



* Average of five bank-week return days; end-of-month levels included with a weight of 50%. — + The target corridor has not been shaded until March because M3 is normally subject to major random fluctuations around the turn of the year. — **1** Between the 4th quarter of the preceding year and the 4th quarter of the current year.

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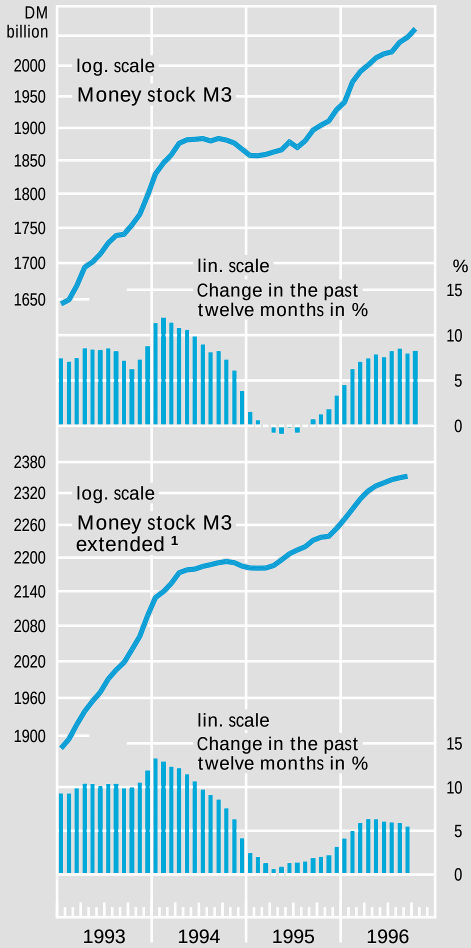
Components of the money stock

Of the individual (seasonally adjusted) components of the money stock, the sharpest increase between August and October was in sight deposits. It is true that high liquidity holdings are not uncommon at times of low short-term interest rates and favourable price expectations. However, the surge of sight deposits in October, in particular, indicates that investors' holding of reserve liquidity for the subsequent purchase of Telekom shares was also a probable factor in this. In the three-month period, savings deposits at three months' notice recorded an almost undiminished sharp growth; during the previous course of the year, they accounted for around three-quarters of overall monetary growth. Their increase was due almost entirely to special savings facilities carrying rates of interest which are comparatively closely in line with market conditions and is likely to have been mainly to the detriment of shorter-term time deposits and monetary capital formation. To that extent, the growth of the money stock shown in the statistics probably overstates at present the expansion of liquidity in the economy which influences expenditure. Between August and October currency in circulation rose only moderately. Shorter-term time deposits, which are not very attractive given present interest rates, continued to decline. On balance, they have now regained their end-1990 level.

Further resales of money market fund certificates

Between August and October domestic non-banks also continued to reduce their holdings of certificates of money market funds (by a total of DM 2.1 billion). During the previous course of the year, they hence resold almost just as many money market fund certificates (DM 8.7 billion) as they had purchased – partly for tax reasons – in December last year (DM 9.7 billion). At present, the demand for such paper is scarcely a factor in the money stock trend. At the same time, domestic money market funds reduced their deposits at domestic banks and at German credit institutions' foreign subsidiaries and foreign branches by a total of DM 0.5 billion between August and October.

Movement of
the money stocks



1 Derived from two end-of-month levels. From August 1994 including money market fund certificates issued by domestic non-banks.

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Subdued growth of the money stock M3 extended

Domestic non-banks likewise continued to reduce their money holdings in the Euro-market between July and September (the figures for October are not yet available) and on balance mostly shifted funds into domestic money circulation. In the third quarter the money stock M3 extended[2], which includes such deposits as well as German non-banks' investment in money market funds, hence rose very moderately. It has also shown a perceptibly weaker trend of late than the traditionally defined money stock M3; in the past twelve months, the money stock M3 extended, at 5½ percentage points, grew 2½ percentage points more slowly than the traditional aggregate M3. Much like the increase in special savings facilities, this is also an indication that the expansionary pace of the money stock M3, if anything, overstates actual liquidity holdings in the economy at present.

Monetary capital formation overshadowed by low capital market rates

Viewed in the balance sheet context of the monetary analysis, weak monetary capital formation remains the factor determining strong monetary growth. Following a slight acceleration in the spring, it slowed down again somewhat between August and October. A major part in this was probably played by the low capital market rates, which acted as a brake on domestic non-banks' propensity to invest longer-term funds, as they have done during past periods of low interest rates. Above and beyond that, the intention to purchase Telekom shares may have deterred a number of investors from buying long-term alternative paper. Finally, monetary capital formation may also have been curbed by uncertainties in connection with the third stage of European Monetary Union. Throughout the period from August to October, banks raised longer-term funds worth DM 22.6 billion from domestic sources, compared

2 Money stock M3, domestic non-banks' deposits with the foreign subsidiaries and foreign branches of German banks and the short-term bank debt securities and certificates of domestic and foreign money market funds in the hands of domestic non-banks, less the bank deposits and short-term bank debt securities of domestic money market funds.

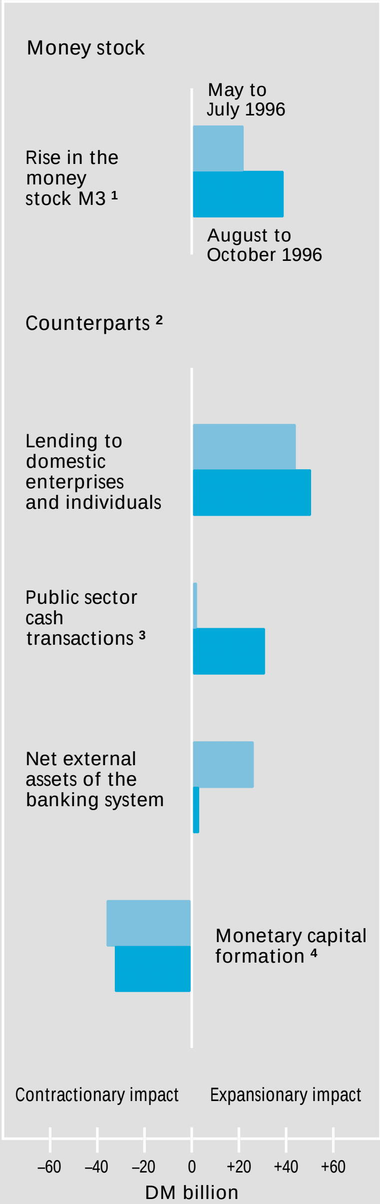
with DM 33.6 a year earlier. After elimination of seasonal influences, monetary capital grew at an annual rate of just under 5 % in the period under review, compared with 5½ % in the preceding three months. More than half of this amount (DM 12.8 billion) was accounted for by long-term time deposits, which also include registered bank debt securities that carry no price risk. Credit institutions received DM 7.1 billion from sales of bank debt securities. Holdings of bank savings bonds rose by DM 3.5 billion. Savings deposits at over three months' notice, by contrast, were reduced by DM 4.1 billion. Banks' capital and reserves were increased by DM 3.2 billion.

Lending to the private sector remains quite vigorous

Bank lending to domestic private borrowers rose somewhat in the period under review, although it did not match the strong growth recorded at the beginning of the year. Between August and October banks granted new loans to enterprises and individuals totalling DM 53.3 billion, compared with DM 63.1 billion in the same period last year. Seasonally adjusted and expressed as an annual rate, this corresponds to an increase of 6 %, compared with just over 5 % between May and July. The decisive factor for this slightly higher increase was the granting of short-term loans, although these were subject to major fluctuations from month to month. By contrast, there was a slowdown in the growth of longer-term lending, which accounts for around three-quarters of all loans granted to enterprises and invididuals. Lending against securities to the enterprise sector was reduced by DM 1.5 billion.

The money stock and its principal counterparts

DM billion, seasonally adjusted, change in the period mentioned



1 M3 as a monthly average. — **2** The changes in the counterparts as shown reflect their expansionary (+) or contractionary (?) impact on the money stock; end-of-month levels. — **3** Lending by the banking system to public authorities less the deposits of the Federal Government in the banking system. — **4** Monetary capital formation by domestic non-banks at domestic credit institutions.

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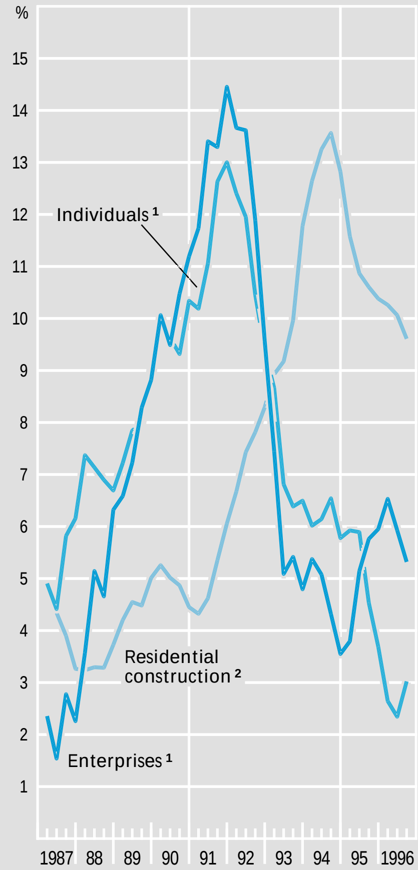
Lending to domestic enterprises and individuals *

Change from previous year in %



* Excluding lending against securities. Statistical changes, such as the 1990 break owing to the inclusion of eastern Germany, are eliminated. — 1 Including mortgage loans (except those secured by residential real estate); excluding housing loans. — 2 Mortgage loans secured by residential real estate and other housing loans.

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Lending, by borrower

According to the quarterly borrowers statistics, which are available only up to the third quarter and which do not include lending against securities, there has been a growth in lending to the housing sector, in particular, during the past few months. Housing loans expanded at an annual rate of 9½% between July and September (against 9% in the second quarter) and hence much more quickly than lending to the other major groups of borrowers. In addition to the further reduction in interest rates for mortgage loans and the new regulations on additional tax allowances for the construction of owner-occupied housing, this trend was probably also fostered by certain anticipatory effects of the cutback in special depreciation regulations for residential housing in eastern Germany at the beginning of 1997. Consumer credit, which had risen fairly moderately in the first half of the year, likewise showed a slight increase in the third quarter, albeit without regaining its multi-year average growth rate. Seasonally adjusted and extrapolated to yield an annual rate, households' indebtedness grew by 5% between July and September, compared with 3½% in the second quarter and 1½% in the first quarter.

Enterprises' borrowing has declined during the past few months, however. Between July and September the enterprise sector increased its indebtedness by a seasonally adjusted annual rate of just over 3½%, compared with just over 5½% in the second quarter and 8% in the first quarter. The individual sectors showed diverging borrowing patterns. Manufacturing, construction and financial institutions reduced their indebtedness to banks. Bank lending to the services sector and the professions, however, was again exceptionally high, although it was not as vigorous as it had been in the first two quarters of the year. For the first time in one-and-a-half years, distribution, which had taken up only very small amounts of new loan funds during the previous course of the year, showed a significantly higher propensity to incur debt in the quarter under review.

Lending commitments at a high level

Banks' new longer-term loan commitments remained at a high level between August and October. This was attributable, in particular, to the fairly resilient demand for housing loans in view of low interest rates and the above-mentioned cuts in tax concessions for residential buildings in eastern Germany which are to be introduced at the beginning of 1997. The number of unused credit lines fell between August and October, but remained comparatively high.

Bank lending rates

Short-term bank lending rates fell only slightly following the 0.3 percentage point lowering of the securities repurchase rate in August. This was true of both time deposit rates and lending rates. For credit in current account, an average of 10 % was again charged for amounts of less than DM 1 million. Instalment credit cost 11½ % on average; bills were discounted at 4¾ % on average in November. Between 2⅓ % (for amounts of less than DM 100,000, running from one month to three months) and just over 2¾ % (for amounts of DM 1 million and over, but less than DM 5 million) were payable for time deposits in November. In long-term lending business, however, effective interest rates were reduced considerably in line with movements in the capital market. For instance, just over 6 % and 7¼ % was payable in November for mortgage loans secured by residential real estate with interest locked in for five and ten years, respectively; and banks demanded an effective rate of just under 6½ % for variable-rate mortgages. The rates have been further reduced since then.

The money stock and its counterparts *

DM billion; change during period

Item	Aug. to Oct. 1995	Aug. to Oct. 1996
I. Bank lending to domestic non-banks, total 1	+ 91.1	+ 80.9
1. Lending by the Bundesbank	– 0.1	± 0.0
2. Lending by credit institutions	+ 91.2	+ 80.9
to enterprises and individuals	+ 63.1	+ 53.3
of which Short-term lending	+ 5.9	+ 10.4
to public authorities	+ 28.1	+ 27.6
II. Net external assets of credit institutions and the Bundesbank	– 12.8	+ 0.1
III. Monetary capital formation at credit institutions from domestic sources, total	+ 33.6	+ 22.6
of which Time deposits for four years and more	+ 11.8	+ 12.8
Savings deposits at more than three months' notice	– 0.3	– 4.1
Bank savings bonds	+ 0.8	+ 3.5
Bank debt securities outstanding 2	+ 17.5	+ 7.1
IV. Deposits of the Federal Government in the banking system 3	– 0.1	+ 0.3
V. Other factors	+ 21.5	+ 29.0
VI. Money stock M3 (Balance: I plus II less III less IV less V)	+ 23.3	+ 29.1
Currency in circulation	+ 2.6	+ 2.0
Sight deposits	+ 14.7	+ 25.2
Time deposits for less than four years	– 17.5	– 14.2
Savings deposits at three months' notice	+ 23.7	+ 16.1
Memo item M3 as a monthly average October 1996 compared with the 4th qtr of 1995 in % 4	.	+ 8.4

* The figures for the latest period are always to be regarded as provisional. — 1 Including lending against Treasury bills and against securities. — 2 Excluding banks' holdings. — 3 Sight deposits and time deposits for less than four years. — 4 Change in the money stock M3 as a monthly average derived from five bank-week return days (end-of-month levels included with a weight of 50 %) from the average in the fourth quarter of 1995, expressed as an annual rate, seasonally adjusted.

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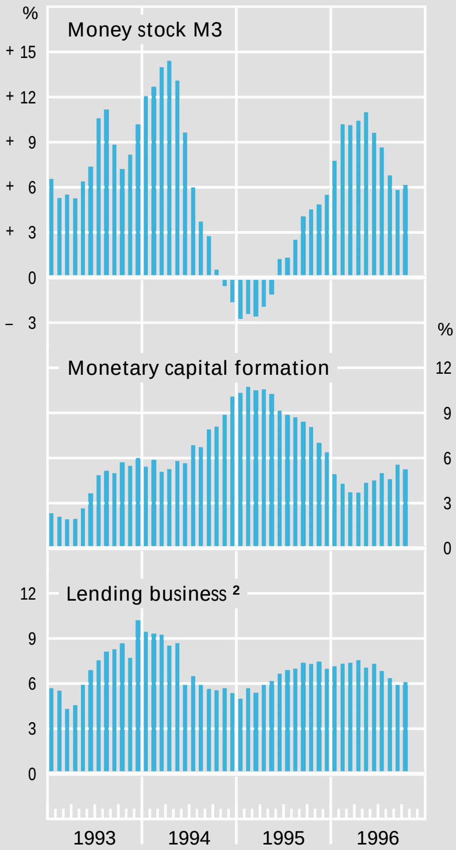
Money stock M3, monetary capital formation and lending business of the banking system *

Seasonally adjusted, annual rate 1



* M3: monthly average; monetary capital and lending business: end-of-month levels. — 1 Change in the last six months expressed as an annual rate. — 2 Lending to domestic non-banks and net external assets.

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Sharp increase in public indebtedness

Bank lending to the public sector had a strong expansionary impact on the money creation process in the period under review, particularly in October. Lending to the public sector rose by DM 27.6 billion and hence on a scale similar to one year earlier (DM 28.1 billion). The bulk of this lending was accounted for by direct lending (DM 25.2 billion). Seasonally adjusted and extrapolated to yield an annual rate, the public sector's indebtedness to banks rose by 11½% between August and October, compared with just under 1% in the preceding three months. This swing is principally due to the fact that the Federal Government and its special funds mainly took up bank loans in the period under review, whereas their financial requirements had on balance been met through sales of debt securities to domestic private investors and foreign investors in the period under comparison. Federal Government deposits in the banking system, which are not counted towards the money stock, were increased by DM 0.3 billion.

Net external assets

Following strong inflows of funds from current and capital transactions with non-residents in the preceding months, domestic non-banks recorded scarcely any inflows of funds between August and October. Net assets of the credit institutions and the Bundesbank, which reflect this trend statistically, remained virtually unchanged throughout the period, compared with an increase of DM 28.5 billion in the preceding three months and a decline of just under DM 13 billion between August and October 1995. The net external position hence had barely any impact on movements in the German money stock during the period under review. If the net external position and all lending transactions are combined to yield the banking system's lending business, this variable has grown at a seasonally adjusted annual rate of 7% during the past three months and thus on a scale similar to lending to domestic non-banks.