Monetary developments

Money market management and central bank money requirements

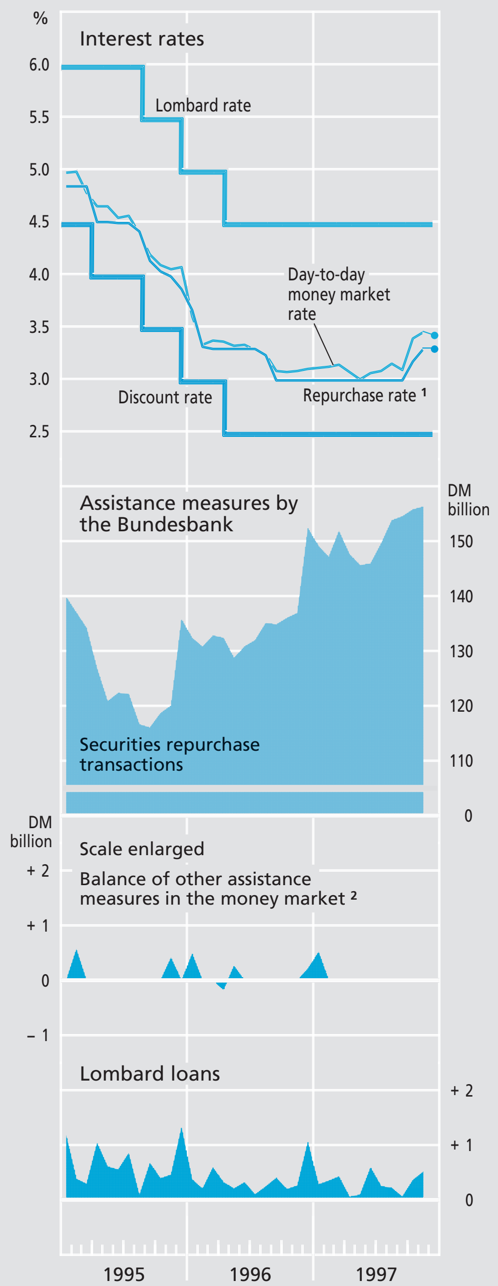
Increase in the repurchase rate in October

In the autumn, the Bundesbank tightened its interest rate policy slightly. After keeping central bank rates unchanged for over a year and, on the whole, at an all-time low, in mid-October the Bundesbank raised the securities repurchase rate from 3.0 % to 3.3 %. It left the discount rate and the lombard rate at 2.5 % and 4.5 %, respectively. By the slight rate increase, the Bundesbank reacted to the increase in stability risks over the summer months. Under those conditions, it seemed advisable to try to further weaken monetary growth in order to forestall the build-up of a monetary inflation potential in the run-up to European monetary union. After the repurchase rate was raised in mid-October, the Bundesbank continued its steady-as-she-goes approach in the money market. As before, it announced the terms of upcoming securities repo agreements in advance at regular intervals coinciding with those of the Central Bank Council meetings. It also adhered to the fixed-rate tender and the interest rate of 3.3 %, thus contributing to stabilising market expectations. This stabilisation-oriented policy was facilitated by a slight brightening-up of the monetary setting as of late following the clouding in the summer months (see also page 13 f.).

Rise in money market rates

The money market rates, which had already tended to rise since mid-July, duplicated the Bundesbank's interest rate move immediately. The quotation of day-to-day money has remained quite stable since then, at around ten basis points above the new tender rate.

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: December 11, 1997.

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The time deposit rates in the spot market, by contrast, continued to rise slightly until mid-November. On the whole, the yield curve in the money market has become somewhat steeper.

International interest rate range

The Bundesbank's decision to raise its repo rate was accompanied by similar measures taken by several other European central banks, with the result that the position of Deutsche Mark money market rates, in the international interest rate range, has remained virtually unchanged; they continue to be at the lower end. By contrast, in countries with a comparatively high interest rate level, the central bank rates – with the exception of the United Kingdom – were lowered; as a result, there was a further narrowing of the interest rate range in the money market sector in Europe.

Money market management through repurchase agreements

Over the whole period under review, ongoing money market management was geared towards keeping the daily fluctuations in central bank balances of credit institutions closely around the level of required minimum reserves and enabling the banking system to comply as steadily as possible with reserve requirements. From September to November, the Bundesbank was able to confine itself to the usual weekly conclusion of securities repurchase agreements with two weeks' maturity. It did not have to take recourse to short-term fine-tuning operations for stabilising the day-to-day money market because no unforeseen liquidity shocks occurred. The banks scarcely took up any lombard loans, either. Only at the end of the months of October and November did their recourse exceed

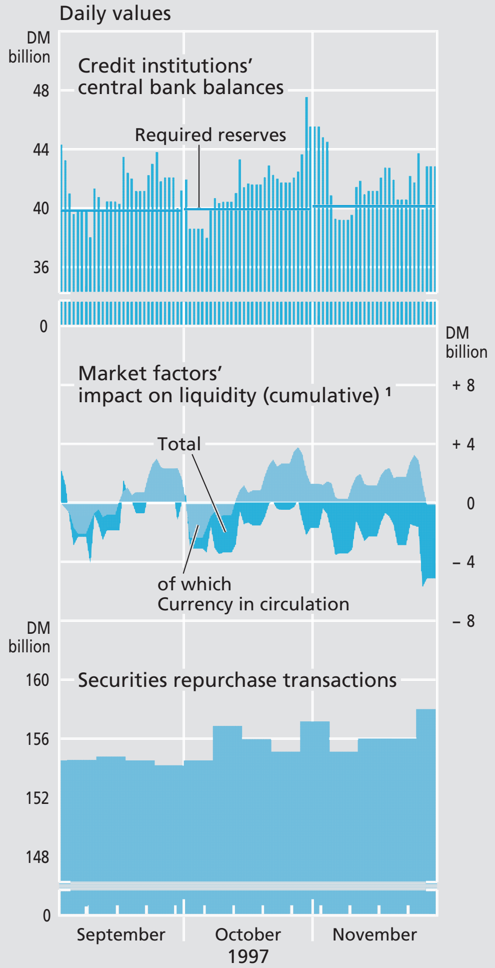
Low volume of lombard loans

the usual frictional basic amounts within the context of concluding minimum reserve operations.

Banks' liquidity requirements

The provision of funds by the Bundesbank, for the most part, had to take account of the fluctuations in currency in circulation typical of the period under review, particularly its strong increase in the beginning of October (Day of German Unity) and at the end of November (when the Christmas shopping season began for retail trade). Moreover, the Bundesbank had to anticipate changes in its net external position. Day-to-day fluctuations of cash items in the process of settlement in the Bundesbank system, often difficult to forecast, were absorbed noiselessly by the buffer function of minimum reserves. In order to expand the float-free settlement of its payments, the Bundesbank began booking the entire volume of paperless direct debit and cheque collection on a same-day supra-regional basis, too, at the end of November. Up to now, float-free settlements in this segment of payment operations were subject to a minimum amount.[1] The effects of the extended procedure are expected to show up primarily beginning in December.

Liquidity management in the autumn of 1997



1 Currency in circulation, the Bundesbank's external position, cash items in the process of settlement and other factors; provision (+) or absorption (–) of central bank balances.

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Central bank money lower

The trend in the principal factors determining bank liquidity for the months of September to November is shown in detail in the table on page 18. Central bank money (currency in circulation held by non-banks and minimum reserves on domestic liabilities at current reserve ratios) decreased distinctly over that period. That owes exclusively to the unwinding of currency in circulation, which is out of line with the seasonal pattern. The demand for currency, having already been below the comparable figures of the past in the summer months, declined noticeably during the period under review, after adjustment for seasonal variations. By contrast, the required minimum reserves increased moderately in line with the monetary expansion. On the

1 See Deutsche Bundesbank, Recent trends in the Deutsche Bundesbank's cashless payments, Monthly Report, August 1994, page 48 f.

Factors determining bank liquidity *

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

Item	1997 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: –)	+ 1.9	+ 0.7	+ 2.6
Currency in circulation	(+ 1.9)	(+ 0.9)	(+ 2.8)
Minimum reserves on domestic liabilities	(– 0.1)	(– 0.1)	(– 0.2)
Memo item Change in seasonally adjusted central bank money	(– 1.7)	(– 1.4)	(– 3.0)
2. Change in the Bundesbank's external position 1	– 1.8	– 0.1	– 1.9
3. Other factors	– 1.7	– 1.8	– 3.5
Total	– 1.7	– 1.1	– 2.8
II. Lasting provision (+) or absorption (–) of funds	– 0.5	+ 0.5	– 0.0
1. Change in refinancing facilities	(– 0.0)	(+ 0.0)	(– 0.0)
2. Recourse to unused refinancing facilities (reduction: +)	(– 0.4)	(+ 0.4)	(– 0.0)
III. Change in the short-term liquidity gap (I plus II; increase: –)	– 2.1	– 0.7	– 2.8
IV. Meeting of remaining deficit (+) or absorption of surplus (–) by			
1. Securities repurchase transactions	+ 2.0	+ 0.5	+ 2.5
2. Lombard loans	+ 0.1	+ 0.2	+ 0.3
Memo items 2			
Unused refinancing facilities	2.7	2.3	2.3
Securities repurchase transactions	155.8	156.3	156.3
Balance of very short-term assistance measures 3	–	–	–
Lombard loans	0.4	0.5	0.5

* For longer-term trends see pages 12*/13* in the Statistical Section of this Report. — 1 Excluding foreign exchange swap transactions. — 2 Levels (in the current month or in the last month of the period). — 3 Quick tenders, foreign exchange swap and repurchase transactions and sales of short-term Treasury bills.

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whole, seasonally adjusted central bank money decreased by DM 3.0 billion between September and November.

Current transactions

Owing to the current transactions of the credit institutions with the Bundesbank, the banks' liquidity was reduced, on balance, in the autumn months. The change in the Bundesbank's external position led to a drain on liquidity totalling DM 1.9 billion. That was caused primarily by the Bundesbank's transactions featuring sales to the market of foreign currency that had previously accrued (in particular, purchases of dollars from US military agencies and interest received on the Bundesbank's external assets), particularly in September and October. "Other factors" drained DM 3.5 billion from the banks. This was primarily due to current entries to the Bundesbank's profit and loss account. In addition, on balance, cash items in the course of settlement in the Bundesbank system, calculated as monthly averages, had contractionary liquidity effects. Moreover, the credit institutions enlarged their cash balances slightly. However, reserves required on foreign liabilities, changes in which are likewise included here in the condensed form of the liquidity account, remained nearly constant over the autumn months, on the whole.

Short-term liquidity gap

On balance, the banks recorded outflows of funds totalling DM 2.8 billion between September and November due to the change in central bank money and to current transactions. Since their rediscount borrowing from the Bundesbank changed only very slightly, the net increase in the short-term liquidity gap over the period under review, therefore, was by the same amount. The Bundesbank covered the increased shortage by increasing the outstanding volume of regular securities repurchase transactions to DM 156.3 billion on a monthly average as of late. Lombard borrowing remained at DM 0.5 billion on a monthly average.

Monetary developments

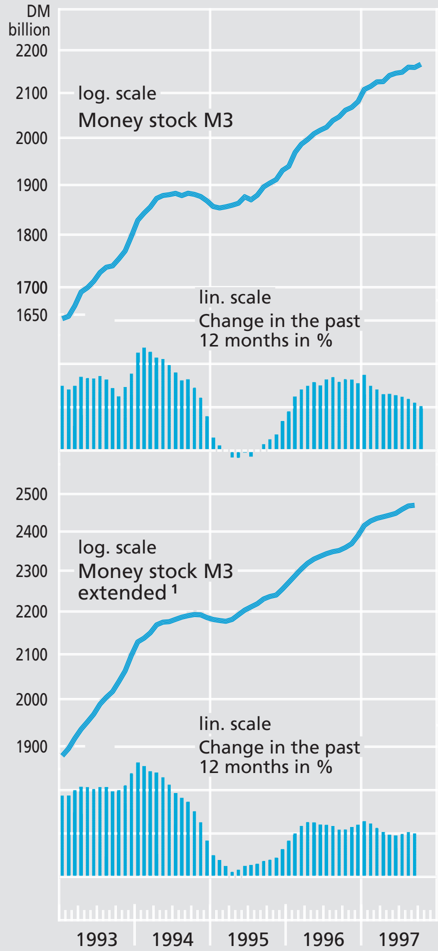
Moderate monetary growth

Recently, cash holdings grew moderately. The money stock M3[2] increased between August and October at a seasonally adjusted annual rate of 3½ %. Monetary growth continued to be volatile from month to month, however. Following a rather sharp increase in August, the money stock M3 remained practically unchanged in September and increased moderately again in October. In October, it exceeded its average level for the fourth quarter of 1996 at a seasonally adjusted annual rate of 5.1 %, compared with 5.2 % in September and 5.8 % in August. It was thus in the middle of this year's target corridor of 3 ½ % to 6½ %.

Determinants of monetary growth

In particular, large outflows of capital in foreign payments by domestic non-banks had a dampening impact on monetary growth in the period under review. Furthermore, lending to the private sector slowed down. By contrast, the slowdown in monetary capital formation had an expansionary effect. Moreover, public sector demand for credit increased. Finally, domestic non-banks made a further overall reduction in their holdings of money market fund certificates.

Movement of the money stocks



1 Derived from two end-of-month levels. From August 1994, including money market fund certificates in the hands of domestic non-banks.

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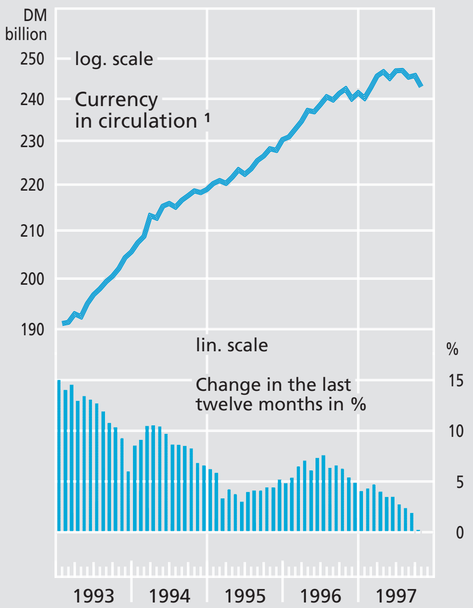
Components of the money stock

Of the individual (seasonally adjusted) components of the money stock, the largest increase between August and October was in savings deposits at three months' notice. On the whole, they were exclusively special savings facilities carrying rates of interest which

2 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; viewed as a monthly average.

Currency in circulation



1 End-of-month level; seasonally adjusted; excluding the credit institutions' cash holdings.

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are comparatively closely in line with market conditions. Their trend growth has continued to slacken, though. During the period under review, the savings deposits at three months' notice grew at a seasonally adjusted annual rate of 6½%, compared with 7½% in the preceding three months and just under 12½% a year ago. Time deposits, which had been reduced so far this year, rose slightly between August and October. However, the key factor here was solely a sharp increase in October. Sight deposits also increased by a slim margin overall – accompanied by strong month-to-month fluctuations. By contrast, currency in circulation declined distinctly. Thus, on balance, the sluggish growth of currency, which has persisted for around a year, has become perceptibly more pronounced. Over the last twelve months, currency in circulation virtually stagnated, compared with a jump of 5% in each of the preceding two years. The share of currency in circulation in the money stock M3 thus declined from just under 12% in mid-1995 to 11¼% most recently.

Further resales of money market fund certificates

Domestic non-banks, on the whole, continued to reduce their holdings of money market fund certificates in the period under review (– DM 1.4 billion). A low volume of purchases in August contrasted with sales in the two following months. Since transactions in money market fund certificates continue to be at rather low levels, they did not exert any perceptible influence on monetary expansion.

Moderate growth in M3 extended

Domestic non-banks sharply stepped up their deposits in the Euro-market between July and September (no information is available for October), after eliminating seasonal influences. The money stock M3 extended,[3] which includes such deposits as well as money market fund certificates held by domestic non-banks, therefore grew somewhat more sharply in the third quarter than in the second quarter, but this growth was still moderate. Over the last twelve months, M3 and M3 extended showed nearly parallel growth, their growth rates being 5½% and 5%, respectively.

Slowdown in lending to the private sector

Banks' lending to enterprises and individuals continued to slacken between August and

3 Money stock M3, domestic non-banks' deposits with the foreign subsidiaries and foreign branches of German banks and the short-term bank bonds and certificates of domestic and foreign money market funds in the hands of domestic non-banks, less the bank deposits and short-term bank bonds of domestic money market funds; calculated as the average of two end-of-month levels.

October. On the whole, the credit institutions' lending to the private sector rose by DM 48.6 billion over that period; seasonally adjusted and expanded to yield an annualised rate, this was an increase of 5 %, compared with just under 6 ½ % between May and July. The main reason for the slowdown in credit expansion was the fact that banks sold securities from the corporate sector worth DM 4.2 billion between August and October. On balance, they were almost exclusively equities (– DM 10.0 billion). Transactions of this kind are mainly conducted in the secondary market and, to that extent, do not influence the granting of new loans to the issuers. The demand for short-term lending to the private sector continued to be very muted between August and October. The rate of expansion of longer-term direct lending, at a seasonally adjusted annual rate of just over 7 %, rose somewhat.

Lending, by borrower

According to the quarterly borrowers statistics, which are only available up to the third quarter and do not include lending against securities, lending by banks to all major groups of borrowers declined somewhat. Domestic enterprises (not including housing loans) stepped up their debt to domestic banks in the third quarter at a seasonally adjusted annual rate of 3 %, following a rate of just over 5 % in the three preceding months. Lending to the transport, storage and communication sectors declined particularly significantly. Lending to the services sector (including the professions) also increased more slowly; all the same, they continued to have a stabilising effect on the entire corporate sector's demand for credit. As in the pre-

The money stock and its counterparts *

DM billion; change during period

Item	Aug. to Oct. 1996	Aug. to Oct. 1997
I. Bank lending to domestic non-banks, total 1	+ 80.9	+ 72.0
to enterprises and individuals	+ 53.4	+ 48.6
of which Short-term lending	+ 10.4	+ 2.4
to public authorities	+ 27.5	+ 23.4
II. Net external assets of credit institutions and the Bundesbank	+ 0.3	– 39.3
III. Monetary capital formation at credit institutions from domestic sources, total	+ 23.0	+ 3.3
of which Time deposits for four years and more	+ 12.6	+ 10.9
Savings deposits at more than three months' notice	– 4.1	– 5.6
Bank savings bonds	+ 3.4	+ 0.8
Bank bonds outstanding 2	+ 7.8	– 11.0
IV. Deposits of the Federal Government in the banking system 3	+ 0.3	+ 0.2
V. Other factors	+ 28.9	+ 23.2
VI. Money stock M3 (Balance: I plus II less III less IV less V)	+ 29.0	+ 6.1
Currency in circulation	+ 2.0	– 2.6
Sight deposits	+ 25.2	+ 5.8
Time deposits for less than four years	– 14.3	– 2.5
Savings deposits at three months' notice	+ 16.1	+ 5.4
Memo item M3 as a monthly average in October 1997 compared with the 4th qtr of 1996 in % 4	.	+ 5.1

* 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 %) compared with the average of the fourth quarter of 1996, expressed as an annual rate, seasonally adjusted.

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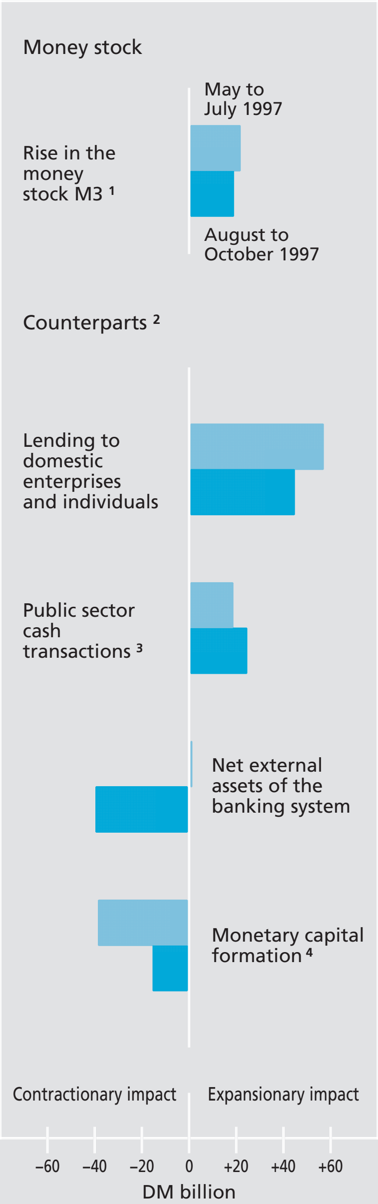
The money stock and its principal counterparts

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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vious quarter, in particular, short-term borrowing by manufacturing declined. That is probably attributable mainly to the cyclically favourable cash flow trend in this sector. The propensity of households to contract debt, which earlier had recovered slightly, declined again in the third quarter. Consumer borrowing rose between July and September at an annualised rate of 4 %, compared with 5 % between April and June. Longer-term loans accounted for the vast majority; that is likely to reflect in part the increased demand for privately owned motor vehicles. At an annualised rate of just over 7 %, housing loans were also down as against the preceding quarter, yet still made an above-average contribution to overall credit growth.

Increase in lending commitments

Over the period under review, new medium and long-term lending commitments, having declined somewhat during the summer months, rose again. Besides the continued rather high demand for housing loans, the interest rate uncertainty which has occurred in the meantime may have been a factor, as it may have convinced some borrowers to secure the current low interest rates over the long term. The amount of commitments outstanding also rose between August and October.

Bank lending rates

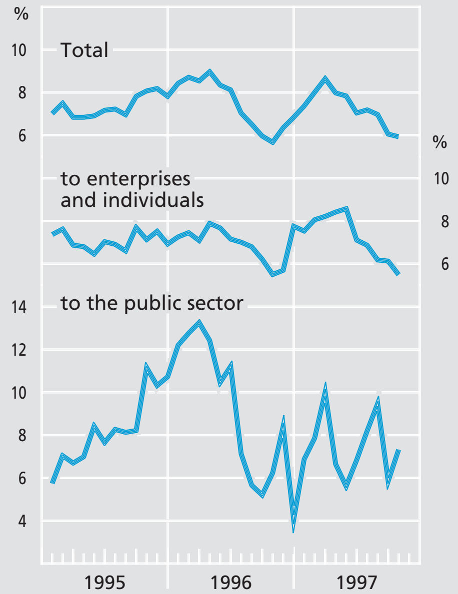
Short-term bank lending rates remained virtually unchanged following the increase of the securities repurchase rate in October by 0.3 percentage points. In November, on average, between 10 % (for amounts of less than DM 200,000) and 7 ⅔ % (for amounts of DM 1 million to less than DM 5 million) were charged for credit in current account. Bills were discounted at an average of 4 ¾ %. The effective rates for long-term loans were governed by the trend in the capital market rates in the individual maturity segments. Mortgage loans secured by residential real estate with interest rates locked in for five years cost almost 6¼% in November, just under one half of one percentage point more than at its lowest point, in July. With interest rates locked in for ten years, the rate to be paid remained 6¾%. Variable-rate mortgages most recently cost 6⅓%. The charge for long-term fixed-rate loans to enterprises and self-employed persons was mostly 6¾% (for amounts of DM 200,000 to less than DM 1 million) and 6½% (for amounts of DM 1 million to less than DM 10 million), respectively.

Large demand for credit by the public sector

During the period under review – except for September – bank lending to the public sector had a strong expansionary impact on the money creation process. Lending to the public sector rose by DM 23.4 billion, all of which was direct credit. At DM 30.0 billion, it increased even more sharply than a year before (DM 25.2 billion), when the propensity of the public sector to contract debt was likewise high. However, the credit institutions reduced their holdings of public sector securities by DM 6.7 billion. Sales in September (– DM 11.0 billion) were a key factor; they probably had something to do with the vibrant demand of foreign investors for such paper during that month. Seasonally adjusted and expressed as an annual rate, bank lending to the public sector rose by 8½% between August and October, compared with just under 6½% in the preceding three months. The Federal Government increased its deposits in the banking system which

Lending by the credit institutions

Seasonally adjusted, annual rate 1



1 Change in the last six months expressed as an annual rate.

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do not count towards the money stock by DM 0.2 billion.

Low monetary capital formation

During the period under review, monetary capital formation by domestic non-banks at credit institutions, having picked up in the early summer, declined again distinctly. The main factors were probably the occasionally rising and relatively violently fluctuating capital market rates, which particularly had a dampening effect on the demand for bank bonds subject to price risks. Over the whole period between August and October, longer-term funds to the tune of only DM 3.3 billion accrued to the credit institutions from domestic sources, only one-seventh of the previous year's total (DM 23.0 billion). After eliminating seasonal influences, monetary capital with banks grew at an annual rate of only

Movement of major lending rates

% p. a.

Type of credit	as in	Average interest rate 1	Spread 2
Personal credit lines 3	Nov. 1996	11.30	10.25–12.25
	Nov. 1997	11.23	9.75–12.25
Current account credit			
from DM 1 million to less than DM 5 million	Jan. 1993	12.06	11.00–13.75
	Nov. 1997	7.69	6.00–10.50
Bills discounted	Jan. 1993	10.36	8.95–12.25
	Nov. 1997	4.76	3.00– 7.00
Mortgage loans secured by residential real estate with interest rates locked in for ten years	Jan. 1993	8.33	7.98– 9.28
	Nov. 1997	6.80	6.59– 7.23
Long-term fixed-rate loans to enterprises and self-employed persons (excluding housing loans) 3			
from DM 200,000 to less than DM 1 million	Nov. 1996	6.85	5.70– 9.23
	Nov. 1997	6.81	5.90– 8.50
from DM 1 million to less than DM 10 million	Nov. 1996	6.57	5.50– 8.30
	Nov. 1997	6.56	5.71– 8.00

1 The average rates are calculated as unweighted arithmetic means from the interest rates reported within the spread. — 2 The spread is ascertained by eliminating the reports in the top 5% and the bottom 5% of the interest rate range. — 3 First collected for November 1996 for the purposes of the restructured interest rate statistics.

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just over 2 % in the period under review, the figure having been 5½ % between May and July. Specifically, domestic non-banks reduced their holdings of bank bonds by DM 11.0 billion between August and October. There was also a decline in savings deposits at over three months' notice (– DM 5.6 billion). Long-term time deposits, by contrast, were increased more sharply than before (DM 10.9 billion). They also include the registered bank bonds, which carry no price risk, and which are attractive to institutional investors in phases of rising capital market rates and major interest rate uncertainty, since they can be shown in the balance sheet at their purchase price and do not need to be written down to a lower market value at the end of the year. The credit institutions received DM 0.8 billion from sales of bank savings bonds between August and October. The banks' capital and reserves increased by DM 8.2 billion.

Outflows of funds in foreign payments

In the period under review, on balance, domestic non-banks' foreign payments generated considerable outflows of funds – with relatively violent fluctuations from month to month – following inflows of funds over the three preceding months. The net external assets of the banking system, a decrease in which reflects such outflows statistically, were down by DM 39.3 billion between August and October, compared with an increase of DM 8.7 billion between May and July. An important role in this turnaround in domestic non-banks' foreign payments was played by the distinctly decreased propensity of foreign investors, on the whole, to invest in the German securities markets, compared with the preceding period.