Monetary developments

Money market management and central bank money requirements

"Steady-as-she-goes" approach to monetary policy

In the spring months, the Bundesbank continued its "steady-as-she-goes" approach to interest rate policy. It left the discount and lombard rates at 2.5 % and 4.5 %, respectively. It continued to offer securities repurchase transactions under fixed-rate tenders at a rate of 3.3 %, announcing the terms in advance in each case following the meetings of the Central Bank Council. The "steady-as-she-goes" approach to interest rate policy was in line with monetary growth which is consistent with the monetary target and overall economic conditions.

Money market rates

Given the unchanged central bank interest rates, the money market rate remained largely stable at about 10 basis points above the fixed-rate tender rate. Time deposit rates initially went up in March and April, but eased again towards the end of the period under review. On balance, longer-term rates rose somewhat more steeply than shorter-term rates. There has been further progress in the convergence of money market rates in the countries participating in EMU. Some central banks in countries where the interest rate level is still comparatively high lowered their interest rates in the period under review; the central bank of Finland, by contrast, raised its rates slightly.

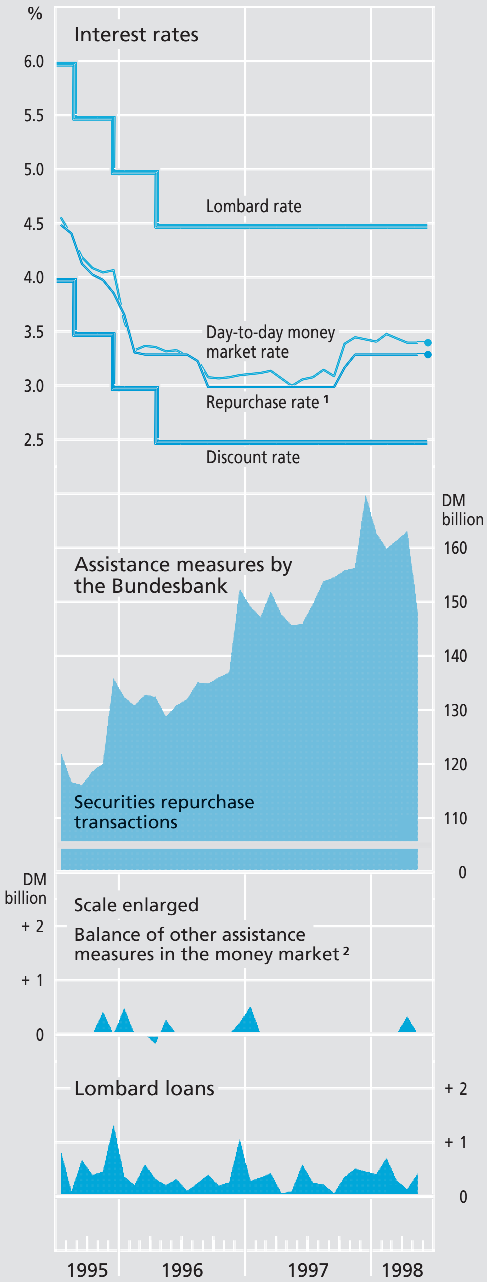
Money market management through securities repurchase transactions

The Bundesbank's ongoing money market management was fairly free of tensions in the period under review and could therefore be confined almost solely to the regular weekly conclusion of securities repurchase transactions. At the same time, the Bundesbank continued to seek to keep the fluctuations of credit institutions' daily central bank balances within narrow limits around the level of the required minimum reserves. In gauging its provision of liquidity it sometimes had to take fairly large fluctuations in credit institutions' needs of funds into account (see the adjacent chart).

Offsetting of profit transfer ...

In particular, it had to neutralise the distribution of the Federal Government's DM 24.2 billion share of the Bundesbank profit for the financial year 1997 on May 18. This record amount resulted, firstly, from the usual interest income accrued on the Bundesbank's domestic and external assets. Secondly, the Bundesbank – as announced in May and June 1997 – took account of the changed external risk position, and, in valuing its foreign exchange holdings, used the latitude available to it resulting from existing accounting regulations. It no longer valued its US dollar holdings at the historically lowest rates but (abiding by the strict principle of the lower of cost or market) at more market-related rates instead, thereby disclosing undisclosed reserves in its profit and loss account. The inflow of liquidity to the money market immediately accompanying the profit transfer was directly offset, given the large amount of securities repurchase agreements outstanding (of DM 163 billion), by a matching same-day maturity of the regular fixed-rate tender and a correspondingly sharp reduction in the new tender volume. At the same time, however, the allocation volumes for the individual securities repurchase transactions were spread accordingly. To restore a more even allocation profile

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: June 12, 1998.

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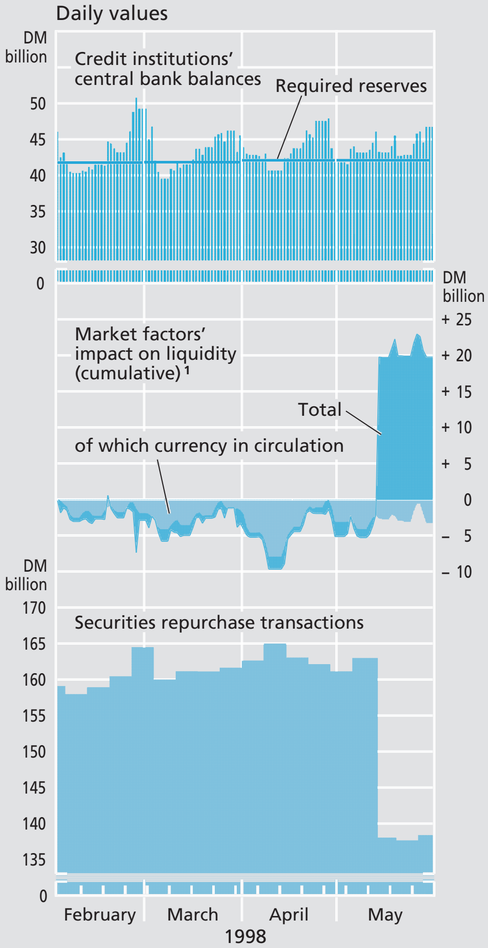
Liquidity management in spring 1998

Daily values



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. Including Bundesbank profit distribution on May 14, 1998.

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the Bundesbank therefore split the subsequent "major" transaction which followed the profit transfer into one two-week and one three-week tranche, with the other terms remaining unchanged.

... and fluctuations in currency in circulation

Major changes to the amounts purchased under the auctions were also necessary in order to offset the fluctuations in currency in circulation over the Easter holiday period. Finally, the repurchase volume outstanding had to be increased markedly at the end of February in view of the comparatively low level of credit institutions' minimum reserves and an exceptionally sharp contractionary fluctuation in cash items in the process of settlement in the Bundesbank system.

Short-term assistance operations

It was only at the end of April that the Bundesbank used short-term fine-tuning measures, when unexpectedly high minimum reserve requirements led to tension in the day-to-day money market. It counteracted these by concluding five-day liquidity-providing foreign exchange swap transactions. For the first time since January 1997 the Bundesbank thus intervened in the money market using a short-term assistance operation.

Offsetting operations by credit institutions

Utilisation of the rediscount quotas, which had increased at the beginning of the period under review in line with the seasonal pattern, has stabilised since March at the higher level. Lombard borrowing was mostly sluggish. At the end of April, too, banks were able to avoid stepping up their recourse to lombard loans; by contrast, at the end of February, March and May they took up lombard loans to a greater extent as part of their final minimum reserve management operations.

Slight fall in central bank money

The trend in the principal determinants of liquidity between February and May is shown in detail in the table on this page. Central bank money (currency in circulation in the hands of non-banks and minimum reserves on domestic liabilities at current reserve ratios) declined by DM 0.6 billion during this period. The main reason for this was that currency in circulation, in contrast to the seasonal pattern, dropped slightly on balance in April and May. Minimum reserves on domestic liabilities, by contrast, decreased somewhat less than usual. After eliminating seasonal influences, central bank money expanded moderately between February and May (by DM 1.7 billion).

Current transactions

On balance, current transactions with the Bundesbank drained some liquidity from credit institutions in the spring. This was mainly due to "Other factors", which reduced credit institutions' central bank balances by DM 4.4 billion. The major part of this reduction resulted from the Bundesbank's ongoing entries to the profit and loss account. At the same time, cash items in the process of settlement in the Bundesbank system had a contractionary impact. Above and beyond that, there was an increase in required minimum reserves on external liabilities, changes in which are booked here in the condensed form of the liquidity account. Finally, the liquidity-increasing reduction in credit institutions' cash holdings was, on balance, lower in spring this year than in the preceding years. The Bundesbank's external transactions, on the other hand, resulted in inflows of funds to banks. The external position increased by DM 3.5 billion between February and May. This change almost exclusively reflects autonomous inflows of foreign exchange – in particular, dollars purchased from US troops and interest income on the Bundesbank's external assets which have no effect on liquidity.

Factors determining bank liquidity *

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

Item	1998		
	Feb. to March	April to May pe	Feb. to May pe
I. Provision (+) or absorption (–) of central bank balances by			
1. Change in central bank money (increase: –)	+ 0.3	+ 0.3	+ 0.6
Currency in circulation	(+ 0.1)	(+ 0.3)	(+ 0.4)
Minimum reserves on domestic liabilities	(+ 0.2)	(+ 0.0)	(+ 0.3)
Memo item Change in seasonally adjusted central bank money	(+ 2.2)	(– 0.5)	(+ 1.7)
2. Change in the Bundesbank's external position 1	+ 1.7	+ 1.8	+ 3.5
3. Other factors	– 1.3	– 3.1	– 4.4
Total	+ 0.8	– 1.1	– 0.3
II. Lasting provision (+) or absorption (–) of funds	+ 0.7	+ 14.1	+ 14.7
1. Change in refinancing facilities	(– 0.1)	(+ 0.0)	(– 0.1)
2. Recourse to unused refinancing facilities (reduction: +)	(+ 0.7)	(– 0.0)	(+ 0.7)
3. Transfer of the Bundesbank profit to the Federal Government	–	(+ 14.1)	(+ 14.1)
III. Change in the short-term liquidity gap (I plus II; increase: –)	+ 1.5	+ 13.0	+ 14.4
IV. Meeting of remaining deficit (+) or absorption of surplus (–) by			
1. Securities repurchase transactions	– 1.3	– 13.1	– 14.5
2. Lombard loans	– 0.1	+ 0.1	+ 0.0
Memo items 2			
Unused refinancing facilities	2.4	2.4	2.4
Securities repurchase transactions	161.3	148.2	148.2
Balance of very short-term assistance measures 3	–	–	–
Lombard loans	0.3	0.4	0.4

* 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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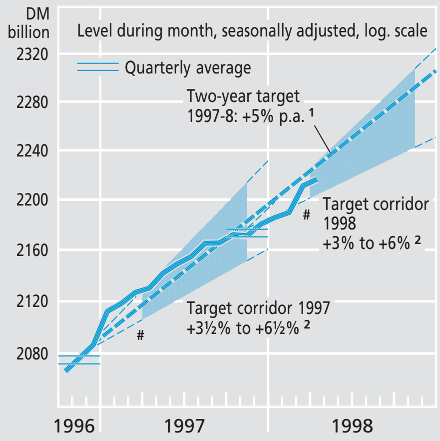
Short-term liquidity gap

On balance, the change in central bank money and current transactions scarcely influenced the banks' liquidity in the spring months. At the same time – as mentioned above – the profit transfer to the Federal Government had a considerable expansionary impact. In combination with the increased utilisation of the rediscount quotas, this caused the lasting provision of funds to rise by DM 14.7 billion between February and May; at DM 14.4 billion, the banks' short-term liquidity gap decreased to almost the same extent. This inflow of liquidity was absorbed by a corresponding cut in the volume of securities repurchase agreements outstanding (to DM 148.2 billion in May). The amount of lombard loans outstanding remained virtually unchanged, at DM 0.4 billion.

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 1996 and the fourth quarter of 1998. — **2** Between the fourth quarter of the previous year and the fourth quarter of the current year.

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Monetary developments

Monetary growth in conformity with target

Entry to this year's monetary target corridor posed no problems. Monetary growth, which had been fairly moderate around the turn of the year, accelerated somewhat in spring but remained within the corridor set by the Bundesbank. In April, the money stock M3[1] exceeded its average level of the fourth quarter of 1997 by a seasonally adjusted 1.9 %; expressed as an annual rate, this is 4.7 %. It was thus roughly in the middle of this year's target corridor of 3 % to 6 %. Compared with the level of the fourth quarter of 1996, M3 also increased by an annual rate of 4.7 % up to April.

Determinants of monetary growth

In the period under review, monetary growth was particularly fostered by an increase in the banks' lending to the private and public sectors; however, lending against securities played a major part in this. In addition, monetary capital formation slackened. By contrast, heavy outflows of funds generated by domestic non-banks' external payments had a dampening effect on monetary expansion. Moreover, for the first time since the summer of 1997 domestic non-banks increased their holdings of money market fund certificates again.

Components of the money stock

Viewed in terms of the seasonally adjusted components of the money stock, the buoyant monetary growth between January and April was largely due to sight deposits. After a fall

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; viewed as a monthly average.

in the last four months of 1997, these have grown exceptionally strongly during the course of this year so far. Currency in circulation, which had likewise declined at that time, remained virtually unchanged; a strong rise in February and March was followed by a fall in April. Even so, the money stock M1, which comprises these two most liquid components of the money stock, increased strongly in the first four months of the year; its year-on-year rise came to 7 %. After a temporary increase at the end of 1997, shorter-term time deposits have been reduced again so far this year. Savings deposits at three months' notice increased moderately; this increase continued to be accounted for solely by higher-yielding special saving facilities.

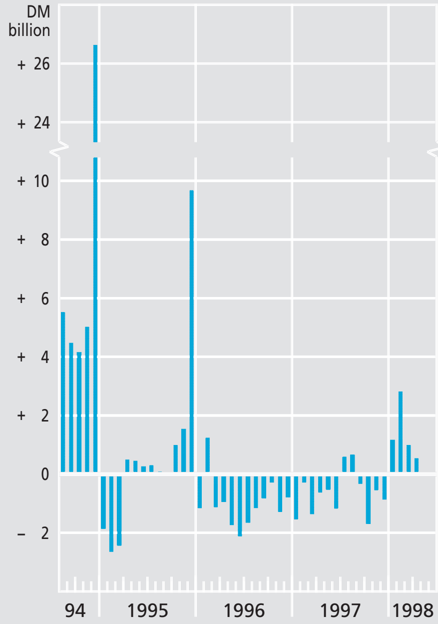
Purchases of money market fund certificates

After domestic non-banks had considerably reduced their holdings of money market fund certificates in the past two years, they bought such certificates on a major scale again in the period under review. Between January and April they purchased DM 5.5 billion net of money market fund certificates, compared with net sales of DM 7.7 billion in 1997 and DM 11.8 billion in 1996. This form of investment is probably becoming somewhat more attractive again in view of the low capital market rates and the flattened yield curve.

Money stock M3 extended

Domestic non-banks also sharply increased their deposits with the foreign subsidiaries and foreign branches of German credit institutions in the first few months of this year. The money stock M3 extended[2] which includes such deposits as well as the money market fund certificates held by domestic non-banks, therefore grew slightly faster between January and March than the money stock M3 (April figures are not yet available). In contrast to this, M3 extended, at 3½ %, expanded somewhat more slowly than M3 (4 %) over the past twelve months.

Net purchases of money market fund certificates by domestic non-banks



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Expansionary stimuli imparted by lending to the private sector

Bank lending to enterprises and individuals accelerated in the first four months of 1998. Altogether, private sector debt to credit institutions increased by DM 98.8 billion between January and April, compared with DM 56.3 billion a year before. Seasonally adjusted and expressed as an annual rate, this corresponds

2 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.

The money stock and its counterparts *

DM billion

Item	Jan. to April 1997	Jan. to April 1998
I. Bank lending to domestic non-banks, total 1	+ 94.8	+ 146.8
to enterprises and individuals	+ 56.3	+ 98.8
of which Short-term lending	– 18.9	– 2.2
to public authorities	+ 38.4	+ 48.0
II. Net external assets of credit institutions and the Bundesbank	– 93.5	– 116.7
III. Monetary capital formation at credit institutions from domestic sources, total	+ 45.3	+ 40.4
of which Time deposits for four years and more	+ 19.3	+ 12.9
Savings deposits at more than three months' notice	– 13.2	– 9.1
Bank savings bonds	+ 2.7	+ 5.0
Bank bonds outstanding 2	+ 26.9	+ 23.9
IV. Deposits of the Federal Government in the banking system 3	– 6.0	– 0.1
V. Other factors	+ 8.7	+ 19.6
VI. Money stock M3 (Balance: I plus II less III less IV less V)	– 46.8	– 29.8
Currency in circulation	– 1.2	– 2.3
Sight deposits	– 66.2	– 27.6
Time deposits for less than four years	– 2.9	– 7.9
Savings deposits at three months' notice	+ 23.5	+ 8.1
Memo item M3 as a monthly average in April 1998 compared with the 4th qtr of 1997 in % 4	.	+ 4.7

* The figures for the latest period are 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 1997, expressed as an annual rate, seasonally adjusted.

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to an increase of 10½ %, against 5 % between September and December 1997.

Lending by type of credit

The stronger credit expansion was mainly attributable, however, to the banks' sizeable purchases of corporate securities. Lending against securities accounted for almost two-thirds of total lending to enterprises and individuals, at DM 61.3 billion. No less than DM 40.9 billion took the form of equities. These transactions took place mainly in the secondary market (partly in connection with derivatives transactions) or as part of transactions with maturities agreed in advance; to that extent, they did not involve any new lending to the issuers. At a seasonally adjusted annual rate of 5 %, short-term direct lending to the private sector likewise expanded slightly more rapidly in the first four months of this year. The rise was concentrated, however, on April, whereas such lending remained fairly subdued in the first quarter. Between January and April, longer-term direct lending increased by a scarcely changed seasonally adjusted annual rate of 6½ %.

Lending by borrowers

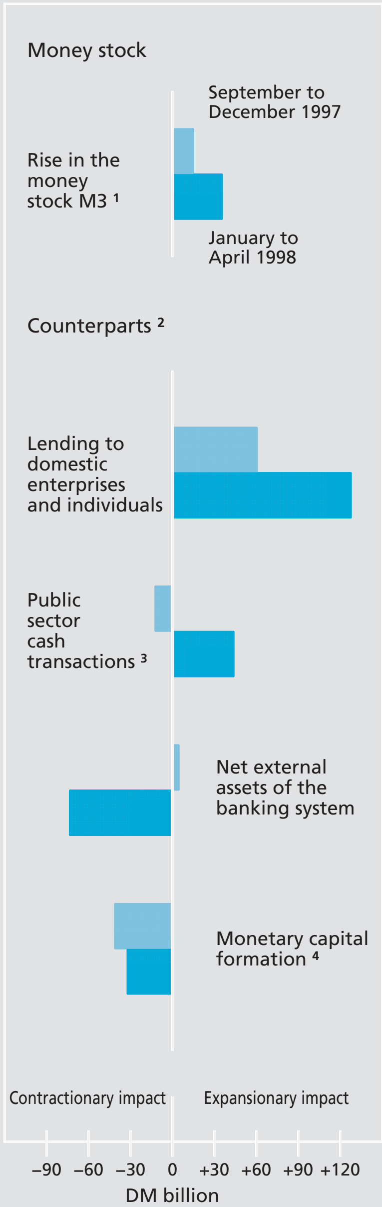
According to the quarterly borrowers' statistics, which do not include lending to the private sector in April and lending against securities, direct lending to enterprises slackened in the first quarter, while lending to households and the housing sector picked up slightly. Domestic enterprises (excluding housing) increased their debt to domestic banks at a seasonally adjusted annual rate of 4½ % in the first quarter, compared with 6 % in the fourth quarter and a good 3½ % in the third quarter of 1997. There was an especially marked decline in the propensity to incur debt on the part of financing institutions and insurance enterprises as well as distribution; the latter noticeably reduced its short-term borrowing. Lending to manufacturing likewise decreased somewhat, which probably owed something to the continuing favourable cash flow trend in this sector. At the same time, there was a perceptible increase in lending to transport, storage and communication. Lending to the services sector (including the professions) picked up again, too, following a deceleration towards the end of 1997. Households' borrowing propensity increased slightly in the first quarter of 1998, but remained moderate overall. Consumer credit rose at a seasonally adjusted annual rate of just under 3 % between January and March, compared with 2½ % in the fourth quarter and 4 % in the third quarter of the previous year. Its growth was concentrated on longer-term credit, which is likely to have owed something to anticipatory effects in the case of consumer durables on account of the increase in value added tax as of April 1 this year. Housing loans, whose growth had slowed down in the second half of 1997, also accelerated slightly in the first quarter of 1998. Such loans expanded at an annual rate of not quite 7 %, compared with just over 6 % in the fourth quarter and slightly less than 7½ % in the third quarter of 1997.

Lending commitments

New lending commitments for medium and long-term loans were at about the same level in the first four months of this year as in the last four months of 1997. The low interest rates, which had continued to fall slightly, may have been a contributory factor in that.

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** Bank lending 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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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
	May 1998	11.26	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
	May 1998	7.68	6.00 – 10.50
Bills discounted	Jan. 1993	10.36	8.95 – 12.25
	May 1998	4.72	3.10 – 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
	May 1998	6.07	5.85 – 6.52
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
	May 1998	6.44	5.54 – 7.91
from DM 1 million to less than DM 10 million	Nov. 1996	6.57	5.50 – 8.30
	May 1998	6.18	5.47 – 7.61

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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Lending commitments outstanding likewise remained on a fairly high level.

Bank lending rates

Short-term bank lending rates have not changed in the past few months. In May, between 10 % (for amounts of under DM 200,000) and 7 ⅓ % (for amounts of between DM 1 million and less than DM 5 million) had to be paid on average for credit on current account. An average 4 ¾ % was charged for bills discounted. The effective rates payable on long-term fixed-rate loans dropped to a historic low in spring in line with trends in the capital market. Mortgage loans secured by residential real estate cost 5 ⅔ % where interest was locked in for five years and just over 6 % for loans with interest locked in for ten years. Just on 6 ¼ % was charged latterly for variable-rate mortgage loans.

Increased lending to the public sector

Bank lending to the public sector increased sharply in the period under review. It went up by DM 48.0 billion, compared with DM 38.4 billion a year earlier. DM 24.9 billion of this amount, or one-half, was accounted for by lending against securities. Its increase was probably partly due to stock lending transactions and takeovers by foreign investors. Direct lending to the public sector expanded strongly, particularly in February and April. In April, one factor might have been that the profit distribution by the Bundesbank to the Federal Government was expected in May. Seasonally adjusted and expressed as an annual rate, bank lending to the public sector rose by almost 11 ½ % between January and April. The deposits of the Federal Government in the banking system, which are not counted towards the money stock, remained virtually unchanged in the period under review.

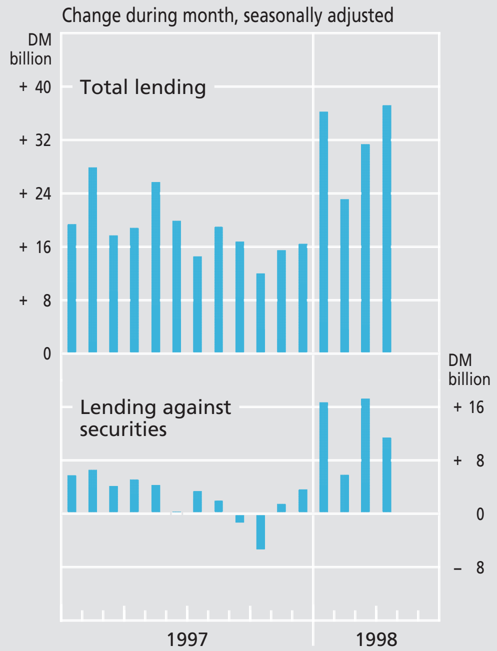
Low monetary capital formation

Between January and April, monetary capital formation was very low. It amounted to DM 40.4 billion, compared with DM 45.3 billion a year before. Seasonally adjusted and expressed as an annual rate, monetary capital grew by 3 ½ % in the first four months of the year, compared with 4 ½ % between September and December 1997. The low propensity to lock in funds at longer-term with domestic credit institutions is likely to have been due partly to the fact that interest rates paid on longer-term assets had fallen sharply in the meantime. Another factor was that investors again purchased foreign securities on a major scale, i.e. shifted their longer-term acquisition of assets abroad, as it were. Between January and April – as is usual at the beginning of the year – most of the funds accrued from sales of bank bonds to domestic non-banks (DM 23.9 billion). Long-term time deposits increased by DM 12.9 billion. Bank savings bonds outstanding went up by DM 5.0 billion. Savings deposits at over three months' notice, by contrast, were run down by DM 9.1 billion. The banks' capital and reserves increased by DM 7.7 billion.

Heavy outflows of funds generated in external payments

Domestic non-banks' current and financial transactions with non-residents generated heavy outflows of funds between January and April. The net external assets of credit institutions and the Bundesbank, a decline in which reflects this statistically, went down by DM 116.7 billion, compared with a fall of DM 93.5 billion a year earlier. The heavy outflows of funds owed something to the fact that enterprises sharply increased their euro-deposits again at the beginning of the year following the usual reduction towards the end of the previous year. Another factor was the above-mentioned heavy buying by German investors in securities markets abroad. To that extent, the outflow of funds generated by domestic non-banks' external payments not only curbed monetary growth, but also domestic monetary capital formation.

Lending to the private sector *



* Lending by credit institutions to domestic enterprises and individuals.

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