Monetary developments

Money market management and central bank money requirements

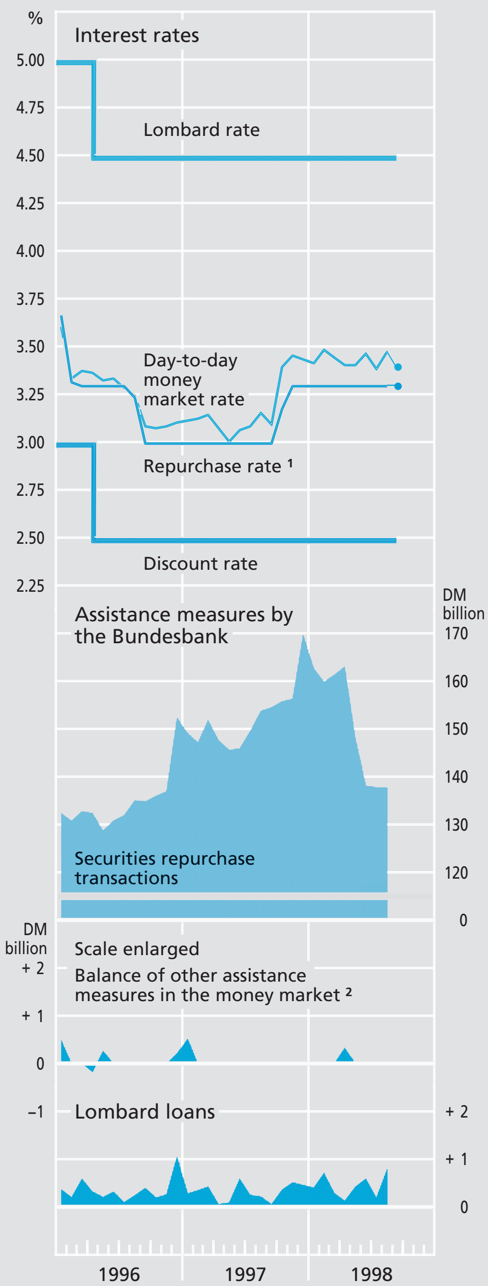
Central bank interest rates unchanged

During the summer months, the Bundesbank continued its "steady-as-she-goes" approach in the money market. It left the discount and lombard rates at 2 ½ % and 4 ½ %, respectively; these rates have not been changed since April 1996. It continued to offer securities repurchase transactions under fixed-rate tenders at a rate of 3.3 %, valid since October of last year, announcing the terms in advance in each case following the meetings of the Central Bank Council. Thus, German central bank interest rates, in a historical comparison, continue to be at a very low level. The steady interest rate policy was in line with the monetary situation and the monetary policy environment in Germany and the participating countries in EMU overall (see page 12).

Domestic and foreign money market rates

Against the background of the stable central bank interest rates, over the past few months the day-to-day money rate continued to be about ten basis points above the fixed-rate tender rate. Time deposit rates, having increased slightly in the spring, tended to ease back down during the period under review. The yield curve in the money market flattened; at present, the rate for one-year funds is only marginally higher than the rates in the very short-term maturity segment. The central banks of other countries in the euro area have also left their central bank interest rates unchanged as of late. On the whole, the Deutsche Mark interest rates remain at the lower end of the international interest rate spectrum.

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: September 10,1998.

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Money market management through securities repurchase agreements

The Bundesbank's ongoing money market management during the summer months was based, as usual, on the regular weekly conclusion of securities repurchase agreements at two weeks' maturity. The Bundesbank has not undertaken any short-term fine-tuning measures in the past few months. The amounts purchased in the repo agreements continued to be gauged in such a manner that the credit institutions' balances at the central bank were as close as possible to the current reserve requirement to make it possible for the banks to fulfil their reserve requirements as evenly as possible (see adjacent chart). As a rule, only minor weekly changes in the volume of the outstanding repo transactions were necessary, particularly to offset the moderate fluctuations in the demand for currency and in the Bundesbank's net external position. In addition, at the beginning of July the Bundesbank had to take account of the payment of its capital share in the European Central Bank (pursuant to Article 28 of the Statute of the European System of Central Banks and the European Central Bank), which amounted to DM 2.1 billion. The ECB's using its capital resources at its disposal resulted in corresponding inflows of liquidity to the banks. In mid-June and particularly at the end of July, however, the central bank balances held by the banks ballooned briefly owing to unforeseen, sharp expansionary fluctuations of cash items in the process of settlement in the Bundesbank system. The Bundesbank counteracted these excessive increases in the liquidity of the banking system by distinctly reducing the repo volume in the next following fixed-rate tender, which led to a correspondingly comprehensive replenishment the week thereafter. All the same, the day-to-day money rate temporarily fell clearly below the repo rate in the last week of July.

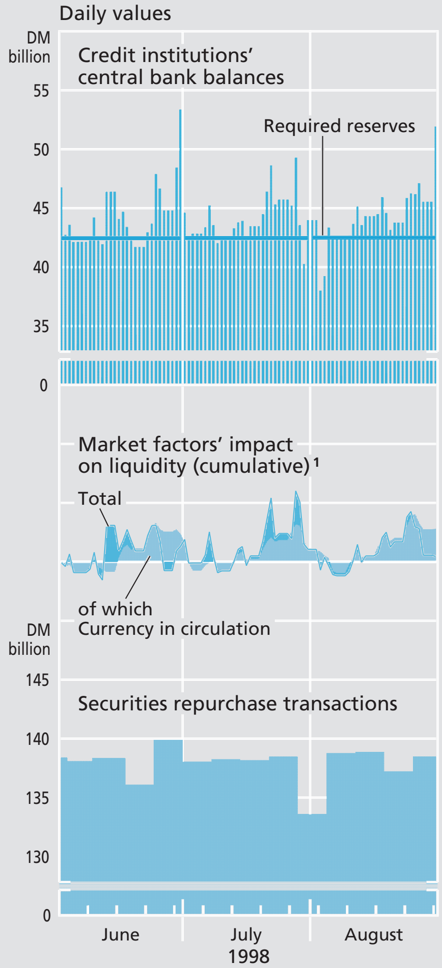
Offsetting operations by credit institutions

The rediscounting of bills of exchange by credit institutions at the Bundesbank went down slightly over the summer months. The utilisation of the rediscount quotas was 96 % on average. Lombard borrowing by banks was sluggish for the most part. Only at the end of each month did banks step up their recourse to lombard loans rather sharply as part of their concluding minimum reserve operations, especially at the end of August, when relatively major contractionary float fluctuations occurred.

Seasonally adjusted central bank money nearly unchanged

The trend in the most important factors determining bank liquidity is shown in detail in the table on page 18, according to which 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 0.7 billion between June and August. This trend, which is atypical of the holiday and vacation period, can be attributed to the demand for currency, which has tended to be sluggish for quite a long time already, and which dominates the change in the overall demand for central bank money. After eliminating seasonal influences, currency in circulation virtually stagnated over the summer months. By contrast, the required minimum reserves rose moderately, which means the seasonally adjusted stock of central bank money has expanded slightly on the whole.

Liquidity management in summer 1998



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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Current transactions

Credit institutions' current transactions with the Bundesbank, on balance, only had a minor impact on banks' liquidity during the period under review. The Bundesbank's external position increased slightly during the period between June and August (by DM 0.1 billion). The autonomous inflows of foreign exchange, i.e. dollars purchased from US troops, and interest income on the Bundesbank's external assets which have no effect

Factors determining bank liquidity *

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

Item	1998 June	July to Aug. pe	June to Aug. pe
I. Provision (+) or absorption (–) of central bank balances by			
1. Change in central bank money (increase: –)	+ 0.4	+ 0.3	+ 0.7
Currency in circulation	(+ 0.7)	(+ 0.1)	(+ 0.9)
Minimum reserves on domestic liabilities	(– 0.4)	(+ 0.2)	(– 0.2)
Memo item Change in seasonally adjusted central bank money	(– 0.3)	(+ 0.6)	(+ 0.3)
2. Change in the Bundesbank's external position 1	+ 0.7	– 0.6	+ 0.1
3. Other factors	– 1.1	+ 0.5	– 0.6
Total	+ 0.0	+ 0.2	+ 0.2
II. Lasting provision (+) or absorption (–) of funds	+ 9.9	+ 0.0	+ 9.9
1. Change in refinancing facilities	– 0.1	+ 0.0	– 0.0
2. Recourse to unused refinancing facilities (reduction: +)	– 0.2	+ 0.0	– 0.2
3. Transfer of the Bundesbank profit to the Federal Government	+ 10.2	–	+ 10.2
III. Change in the short-term liquidity gap (I plus II; increase: –)	+ 9.9	+ 0.2	+ 10.1
IV. Meeting of remaining deficit (+) or absorption of surplus (–) by			
1. Securities repurchase transactions	– 10.0	– 0.4	– 10.5
2. Lombard loans	+ 0.2	+ 0.2	+ 0.4
Memo items 2			
Unused refinancing facilities	2.6	2.6	2.6
Securities repurchase transactions	138.1	137.7	137.7
Balance of very short-term assistance measures 3	–	–	–
Lombard loans	0.6	0.8	0.8

* 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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on liquidity, contrasted with rechannelling of some foreign exchange. The "Other factors" caused the credit institutions' funds, taken by themselves, to be reduced by just over DM 0.5 billion. That is primarily due to the Bundesbank's ongoing entries to its profit and loss account. In addition, reserves required for external liabilities, changes in which are booked here, too, in the condensed form of the liquidity account, rose during the summer months. By contrast, the aforementioned use by the European Central Bank of the capital share paid up by the Bundesbank at the beginning of July and shown here had a major liquidity-increasing effect. Moreover cash items in the process of settlement in the Bundesbank system had a slightly expansionary impact, on balance, calculated as a monthly average. Overall, from June to August, the change in central bank money and current transactions caused DM 0.2 billion worth of funds to accrue to banks.

Short-term liquidity gap

The liquidity effect of the transfer of the Bundesbank's profit to the Federal Government in mid-May (to the tune of DM 24.2 billion) is reflected in the liquidity account, expressed as a monthly average, even as late as June (+ DM 10.2 billion). The credit institutions' rediscounting of bills of exchange was reduced during the summer months by DM 0.3 billion. On balance, the banks' short-term liquidity gap in August was DM 10.1 billion lower than in May. The Bundesbank absorbed this by reducing the volume of regular securities repurchase agreements, with most of this reduction already taking place in May, the month when the profit was transferred. Recourse by credit institutions to lombard loans rose slightly to a monthly average of DM 0.8 billion.

Monetary developments

Monetary growth remains in target corridor

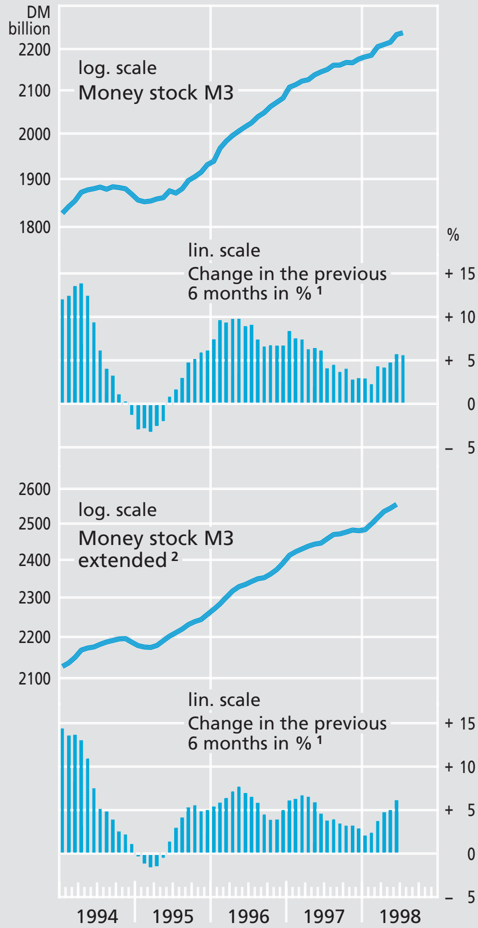
During the last few months, monetary growth remained within the corridor striven for by the Bundesbank. However, it became rather volatile from month to month. Monetary expansion was very moderate in May and July but sharp in June. In July, the money stock M3 exceeded its average level of the fourth quarter of 1997, after adjustment for seasonal variations, by 3.3 %; expressed as an annual rate, this is 5.0 %, following 5.3 % in June and 4.4 % in May. Thus, the money stock M3[1] remained within this year's target corridor of 3 % to 6 % during the entire period. Compared with the level of the fourth quarter of 1996, M3 increased by a seasonally adjusted annual rate of 4.8 % up to July, compared with 4.9 % up to June and 4.6 % up to May.

Determinants of monetary growth

Monetary growth was once again fostered by slackening capital formation during the period under review. This was also compounded by the high amount of profit transferred by the Bundesbank to the Federal Government. The fact that there was a decrease in outflows of funds generated by domestic non-banks' external payments had a similar effect. However, these expansionary influences contrasted with a decrease in lending to the private and public sectors. Domestic non-banks increased their holdings of money market fund certificates only slightly.

Movement of the money stocks

Seasonally adjusted



1 Extrapolated to yield an annual rate. — 2 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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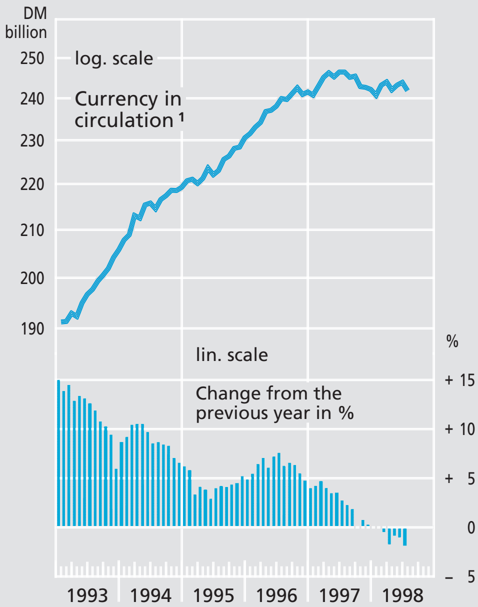
Components of the money stock

Among the (seasonally adjusted) components of the money stock, the shorter-term time deposits increased most sharply between May and July. In light of the flattened yield curve and the low capital market rates, they seem to have regained some of their attract-

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.

Movement of currency in circulation



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

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iveness, just like money market fund certificates. Savings deposits at three months' notice also rose rather sharply, the rise once again being solely attributable to special savings facilities. The very strong growth of the sight deposits from the first four months of the year slackened, though. Between May and July currency in circulation stagnated; over the past twelve months it declined slightly.

Minor purchases of money market fund certificates

During the period under review, domestic non-banks continued to replenish their holdings of money market fund certificates (DM 1.6 billion). Fewer certificates were purchased than during the period between February and April (DM 4.3 billion), however. There were no noticeable effects on monetary growth.

Growth of M3 extended somewhat sharper than that of M3

Between April and June (no information for July is available yet), domestic non-banks increased their deposits with the foreign subsidiaries and foreign branches of German credit institutions, too, to a lesser extent than in the first part 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, at a seasonally adjusted annual rate of just over 6 %, therefore grew once again somewhat more sharply in the second quarter than M3, which at the same time expanded at an annual rate of 5 ½ %.

Slackening of lending to the private sector

Bank lending to domestic enterprises and individuals slackened after having picked up in the first four months of 1998. Credit institutions' lending to the private sector rose by DM 40.5 billion between May and July, compared with DM 49.0 billion a year ago. Seasonally adjusted and expressed as an annual rate, this means a rise of 5 ½ %, against 10 % between February and April. However, the lower volume of lending is attributable entirely to a slump in lending against securities. Whereas domestic credit institutions purchased DM 42.6 billion worth of corporate securities between February and April, particularly equities, they sold such securities for DM 15.0 billion between May and July. These securities transactions take place mainly in the secondary market. To that extent, they do not involve injection of any new loans or the

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.

withdrawal of old loan funds from the issuers. Between May and July direct lending virtually remained at the level of the preceding three months. In detail, longer-term lending rose at a seasonally adjusted annual rate of just under 6½% and short-term lending to the private sector at an annual rate of 7%.

Lending by borrowers

According to the quarterly borrowers' statistics, which include neither lending against securities nor credit expansion in July, direct lending to domestic enterprises and households picked up in the second quarter, whereas the increase in lending to the housing sector remained largely unchanged. Between April and June domestic enterprises increased their debt to banks at a seasonally adjusted annual rate of 6½%, against 4½% in the first quarter. Bank lending increased, particularly that to transport, storage and communication, as well as distribution. By contrast, manufacturing reduced its propensity to incur debt. This may be attributable in part to the somewhat flattened output trend in the second quarter. Consumer credit rose at a seasonally adjusted annual rate of 7% between April and June, compared with just under 3% in the first quarter. Housing loans also grew at a (virtually unchanged) seasonally adjusted annual rate of 7% in the second quarter. The demand for credit was focused on the financing of owner-occupied housing and renovation work.

Increase in lending commitments

New lending commitments for medium and long-term loans were higher during the period under review than in the three preceding months. This may be attributable in part to the low interest rates, which have con-

The money stock and its counterparts *

DM billion

Item	May to July 1997	May to July 1998
I. Bank lending to domestic non-banks, total 1	+ 61.5	+ 38.9
to enterprises and individuals	+ 49.0	+ 40.5
of which Short-term lending	+ 4.6	+ 11.7
to public authorities	+ 12.5	– 1.6
II. Net external assets of credit institutions and the Bundesbank	+ 8.7	– 27.8
III. Monetary capital formation at credit institutions from domestic sources, total	+ 37.4	+ 20.4
of which Time deposits for four years and more	+ 7.6	+ 8.8
Savings deposits at more than three months' notice	– 6.4	– 5.7
Bank savings bonds	+ 1.8	– 0.2
Bank bonds outstanding 2	+ 21.7	+ 10.1
IV. Deposits of the Federal Government in the banking system 3	– 0.6	+ 0.1
V. Other factors	+ 23.8	– 13.4
VI. Money stock M3 (Balance: I plus II less III less IV less V)	+ 9.6	+ 4.0
Currency in circulation	+ 1.0	– 0.4
Sight deposits	+ 17.5	+ 2.6
Time deposits for less than four years	– 10.9	+ 3.8
Savings deposits at three months' notice	+ 2.1	– 2.0
Memo item M3 as a monthly average in July 1998 compared with the 4th qtr of 1997 in % 4	.	+ 5.0

* 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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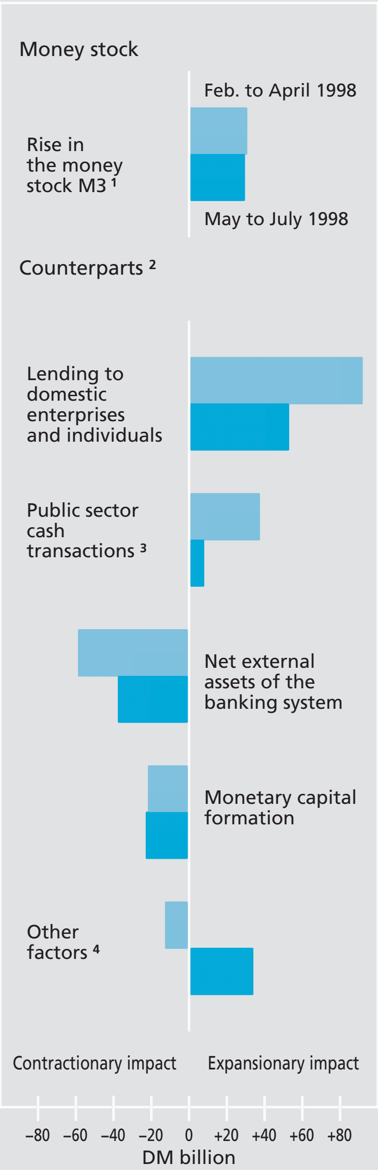
The money stock and its principal counterparts

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 The expansionary stimulus exerted by "Other factors" between May and July is due mainly to the Bundesbank's profit transfer to the Federal Government amounting to DM 24.2 billion.

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tinued to fall. Lending commitments outstanding, however, fell slightly of late.

Bank lending rates

Short-term bank lending rates have remained virtually unchanged in the last few months. In August, between 10 % (for amounts of under DM 200,000) and just over 7 ½ % (for amounts between DM 1 million and less than DM 5 million) had to be paid, on average, for credit on current account. An average of 4 ¾ % was charged for bills discounted. The effective rates payable on long-term fixed-rate loans dropped to all-time lows in line with capital market rates. In August, mortgage loans secured by residential real estate cost just under 5 ½ % where interest was locked in for five years and just over 5 ¾ % with interest locked in for ten years. Just over 6 % was charged as of late for variable-rate mortgage loans. For long-term fixed-interest loans to enterprises and self-employed persons, 6 ¼ % (for amounts between DM 200,000 and less than DM 1 million) and 6 % (for amounts from DM 1 million to less than DM 10 million) were mostly charged.

Slackening of lending to the public sector...

The very high volume of bank lending to the public sector during the first four months slackened distinctly between May and July. Bank lending to the public sector picked up in those months at a seasonally adjusted annual rate of only 2 ½ %, compared with almost 13 % between February and April. Before excluding seasonal influences, it went down by DM 1.6 billion compared with an increase of DM 12.5 billion a year ago. The decrease was solely in direct lending (– DM 6 billion), whereas lending against securities continued to increase, although much less sharply than

... yet huge profit distributed by the Bundesbank

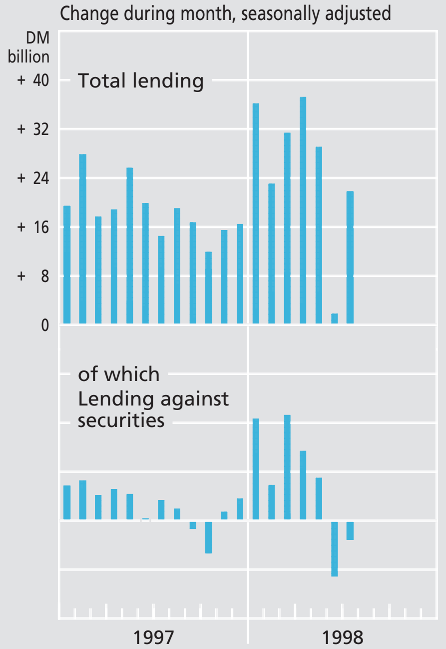
during the preceding period. The Federal Government in particular reduced its direct borrowing sharply. This trend, however, is to be seen against the background of the Bundesbank's profit distribution to the Federal Government in May, which set a record at DM 24.2 billion.[3] If it is combined with bank lending to the public sector, then the public sector, through its cash operations, continued to vigorously enhance monetary growth during the period under review.

Low monetary capital formation

Monetary capital formation at credit institutions was once again very low during the entire period under review. It amounted to a mere DM 20.4 billion, as against DM 37.4 billion a year before. Seasonally adjusted and expressed as an annual rate, monetary capital held at banks rose by 3 % between May and July, and thus just as sluggishly as between February and April. In detail, DM 10.1 billion accrued to credit institutions in the period under review from sales of bank bonds. Almost all of this amount accrued in July, whereas non-banks' purchases of those securities subject to price risks were very low in May and June. Long-term time deposits were formed to the tune of DM 8.8 billion. By contrast, savings deposits at more than three months' notice continued to be run down (– DM 5.7 billion). Investment in bank savings bonds, too, decreased slightly (– DM 0.2 billion). The banks' capital and reserves increased by DM 7.4 billion.

Domestic non-banks' current and financial transactions with non-residents continued to generate outflows of funds between May and July. These outflows were lower than in

Lending to the private sector *



* Lending by credit institutions to domestic enterprises and individuals.

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Outflows of funds generated in external payments

the preceding months, though. This factor therefore dampened monetary growth to a lesser degree than before, on balance. The net external assets of the banking system, a decline in which reflects outflows of funds from non-banks statistically, went down by DM 27.8 billion in the period under review, compared with a decline of DM 71.2 billion between February and April but with an increase of DM 8.7 billion a year before. Heavy buying of domestic securities by foreign investors contributed to the low outflows of funds.

3 In the statistical figures of the monetary analysis, this is reflected in a corresponding, expansionary decrease in "Other factors".