Monetary policy, capital markets and banking business

Interest rate policy and the money markets

Eurosystem interest rates unchanged and stable outlook for prices

In the past few months, the ECB Governing Council has continued to leave rates unchanged. The main refinancing operations were still conducted as interest rate tenders with a minimum bid rate of 2%. The interest rates on the marginal lending facility and the deposit facility were also left unchanged at 3% and 1% respectively. The steady interest rate policy course was based on the assessment that the outlook for price stability in the euro area would remain favourable.

Money market interest rates

Market participants had been informed well in advance of upcoming changes in the institutional conditions of the Eurosystem's monetary policy instruments: these changes became effective at the beginning of March. First, the maturity of the main refinancing operations was shortened to just one week. Second, the start of the minimum reserve maintenance period was changed to coincide with the settlement day of the main refinancing operation, which takes place after the first meeting of the ECB Governing Council each month. As the transition to the new institutional conditions was accompanied by a generous provision of central bank money to the banks, before the end of the exceptionally long reserve maintenance period (from the end of January to the beginning of March), the overnight rate (EONIA) slid temporarily below the minimum bid rate. By contrast, at the end of the reserve maintenance period March/April, liquidity was in demand, resulting in a short-term surge in the EONIA. Apart from these exceptions, however, the overnight rate hovered closely

Money market management and liquidity needs

The Eurosystem introduced a number of innovations in its money market management in the first quarter of 2004. Thus, for example, the March-April reserve maintenance period began on 10 March rather than on 24 March in accordance with the provisions under the new operational framework for monetary policy. The first main refinancing operation was settled on that day following the monthly monetary policy meeting of the ECB Governing Council which, in this case, had been held on 4 March. Moreover, the first regular main refinancing operation with a shorter maturity of one week rather than two weeks was also settled on 10 March. Following the end of the last two-week operation of 3 March, as of 17 March, only one Eurosystem main refinancing operation will be outstanding at any time.

In the period from 24 January to 6 April, the demand for central bank balances, which is driven by the autonomous factors determining liquidity, increased by €5.5 billion (see adjacent table). The volume of banknotes in circulation fell by €9.6 billion in the January-March period, which meant that the sharp rise in the previous period as a result of Christmas and New Year was largely reversed. However, banknotes in circulation increased again by €7.3 billion in March and April owing, not least, to the upcoming Easter holidays.

General government deposits rose by €14.5 billion in the period under review. The decline in the Eurosystem's foreign reserves by €7.8 billion – which without the rise would have been somewhat greater owing to the end-of-quarter revaluation on 31 March – also withdrew liquidity from the banking system. By contrast, €14.5 billion was provided by means of other factors, predominantly through an increase in the Eurosystem's holdings of euro-denominated financial assets not connected with monetary policy.

This time the Eurosystem did not meet the additional liquidity requirements by boosting the volume of its main refinancing operations – which were actually reduced by €14.7 billion – but by increasing the volume of longer-term refinancing operations (by €22.1 billion). Starting with the operation on 29 January, the Eurosystem achieved this by expanding the volume of the individual operations from €15 billion to €25 billion.

On balance, credit institutions' current account holdings increased by €1.7 billion. Taking into account the overcompliance with minimum reserve requirements, which was significantly less pronounced in the January-March period than in the preceding period, it was possible to fulfil the higher requirements (up by €1.9 billion) without any problems.

The interest rate for overnight deposits (EONIA) on the interbank market mostly remained, as usual, a few basis points above the minimum bid rate of 2.00%. Larger deviations occurred only in the last few days of the reserve maintenance periods. The lowest level (1.84%) was attained on 5 March and the highest level (2.75%) on 6 April. Thus, the transition to the new operational framework for monetary policy in money market management was largely smooth.

Factors determining bank liquidity[1]

€ billion; calculated on the basis of daily averages of the maintenance periods

Item	2004: 24 Jan to 9 Mar	2004: 10 Mar to 6 Apr
I Provision (+) or absorption (–) of central bank balances by		
1 Change in banknotes in circulation (increase: –)	+ 9.6	– 7.3
2 Change in general government deposits with the Eurosystem (increase: –)	– 11.6	– 2.9
3 Change in net foreign reserves [2]	– 5.9	– 1.9
4 Other factors [2, 3]	+ 9.9	+ 4.6
Total	+ 2.0	– 7.5
II Monetary policy operations of the Eurosystem		
1 Open market operations		
(a) Main refinancing operations	– 13.2	– 1.5
(b) Longer-term refinancing operations	+ 11.7	+ 10.4
(c) Other operations	–	–
2 Standing facilities		
(a) Marginal lending facility	+ 0.1	– 0.0
(b) Deposit facility (increase: –)	– 0.1	– 0.2
Total	– 1.5	+ 8.7
III Change in credit institutions' current accounts (I + II)	+ 0.5	+ 1.2
IV Change in the minimum reserve requirement (increase: –)	– 0.7	– 1.2

1 For longer-term trends and the contribution of the Deutsche Bundesbank, see pages 14* and 15* of the Statistical Section of the *Monthly Report.* — **2** Including end-of-quarter valuation adjustments with no impact on liquidity. — **3** Including monetary policy operations concluded in the second stage and still outstanding in the third stage of monetary union (outright transactions and the issuance of debt certificates) as well as financial assets not connected with monetary policy.

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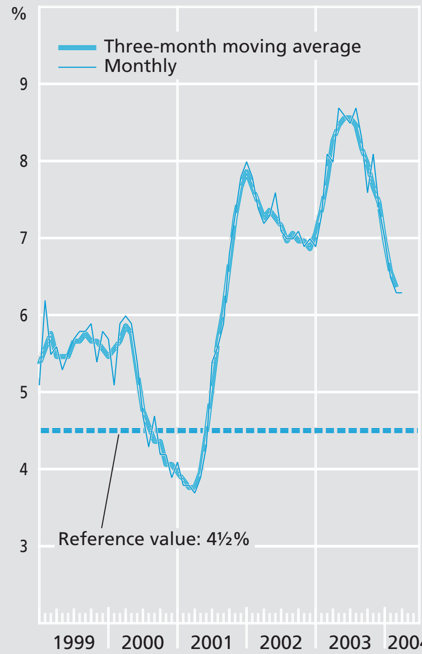
around the minimum bid rate of the main refinancing operations throughout most of the period under review.

In the period under review, longer-term interest rates in the money market reflected market participants' expectations of a change in the rate of interest. While the yield spread between twelve-month funds and overnight money at the beginning of February was still nearly ¼ percentage point at the end of March, the twelve-month Euribor was actually below the overnight rate of around 2%. However, the ECB Governing Council's decision at its 1 April meeting to maintain its steady monetary policy course, dispelled temporary expectations of an interest rate cut. At the end of April, twelve-month funds were trading just under ¼ percentage point above overnight funds: hence, longer-term interest rate expectations on the money market look set to rise again.

Growth of the money stock M3 in the euro area

Seasonally adjusted, annual percentage change



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Monetary developments in the euro area

Slowdown in monetary expansion

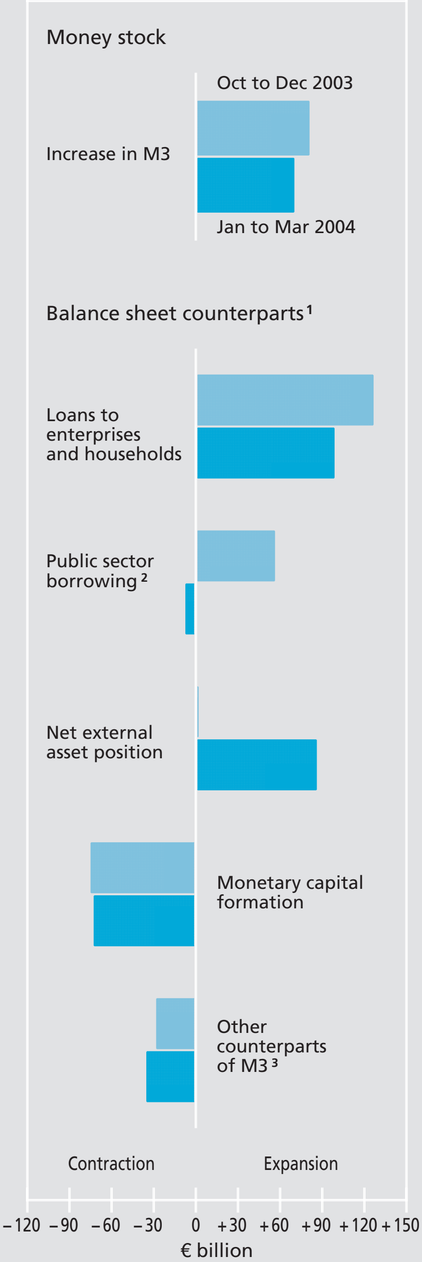
In the first quarter, euro-area M3 again rose slightly less than in the previous quarter. In annualised seasonally adjusted terms, the three-month rate was 4½% at the end of March. At the same time, the three-month moving average of annual rates of change went down from 7.5% for the period between October and December to 6.4% for the period between January and March. In the quarter under review, two factors curbed the growth of M3: a lower growth in lending to the private sector and, probably to a greater extent, the surge in monetary capital formation. Bank debt securities with a maturity of over two years were particularly in demand, which suggests that investors' preference for liquidity is falling gradually. Yet current cash holdings are still clearly larger than necessary to finance inflation-free economic growth. Under current conditions this does not pose acute risks to price stability, especially since a certain "normalisation" in cash holdings has been observed. However, since it cannot be ruled out completely that this surplus liquidity won't have any impact on demand in the commodities markets, monetary trends must continue to be monitored carefully.

Components of the money stock

Of the individual components of the monetary aggregate M3, overnight deposits rose sharply in the January to March period, after having grown perceptibly weaker in the previous quar-

Euro-area M3 and its balance sheet counterparts

€ billion, seasonally adjusted, change over the period indicated



1 Changes in balance sheet counterparts are shown in terms of whether they expand (+) or contract (–) the money stock. — 2 Bank loans to general government less euro-area general government deposits and holdings of securities issued by the MFI sector. — 3 Calculated as errors and omissions from the remaining items of the consolidated balance sheet of the MFI sector.

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ter vis-à-vis earlier quarters. Its seasonally adjusted annual rate rose to over 14% in the period under review (from just under 6½% in the October to December period). Also currency holdings again increased sharply. Overall, the monetary aggregate M1 rose by 15% in the first quarter of 2004. By contrast, other short-term bank deposits (excluding overnight deposits) were depleted perceptibly in net terms in the quarter under review. However, this decline related exclusively to short-term time deposits, which continued to be depleted at a quicker pace. Deposits redeemable with a period of notice of up to three months, however, increased noticeably. In seasonally adjusted terms, the volume of marketable instruments included in M3 also declined strongly in the first quarter. Repo transactions were particularly reduced and the amount outstanding of money market fund shares declined slightly, too. At the end of the period under review, only the volume of money market paper and short-term bank debt securities increased somewhat.

Balance sheet counterparts

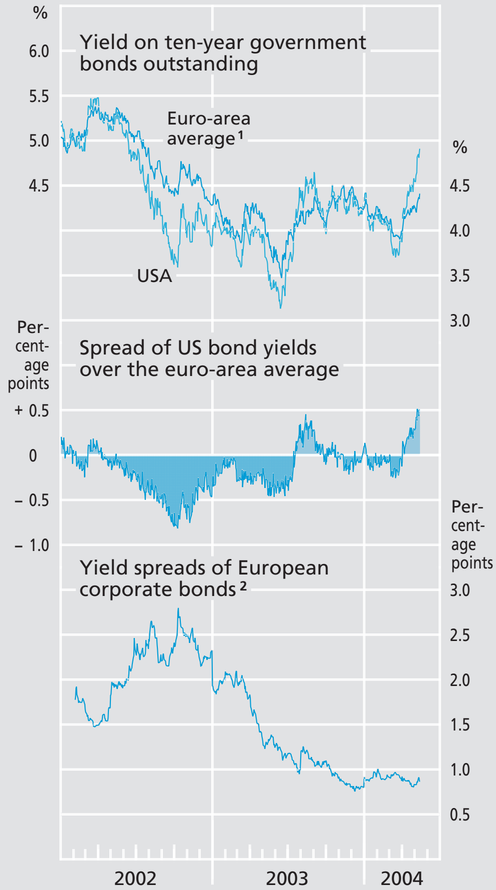
Of the balance sheet counterparts, loans to domestic enterprises and individuals posted weaker growth in the period under review than in the previous quarter. This concerns primarily loans to the private sector which in the first three months of this year grew at a seasonally adjusted annualised rate of just over 4½% after having grown by 6½% in the October to December 2003 period. Despite attractive financing terms, which were reflected mainly in strong demand for housing loans, the moderate expansion of loans to enterprises dampened credit growth in the euro area.

The growth of credit to the euro-area public sector also weakened. In non-seasonally adjusted terms, these grew in the January to March period by €57 billion, and, much like in the previous years, a very large portion thereof (€52 billion) was in the form of securitised lending. Moreover, taken in isolation, the marked increase in central government deposits subdued monetary expansion in the quarter under review.

M3 growth, by contrast, was stimulated by heavy capital inflows from foreign payment transactions at the end of the period under review. The net external asset position of the MFI sector, which reflects payments between non-banks and the non-euro-area countries, rose by €35½ billion. A share of these cross-border inflows may have also been absorbed by the perceptible increase in monetary capital formation over the course of the quarter under review. Domestic MFIs were again able to place large volumes of bank debt securities with a maturity of over two years outside the domestic banking sector. This is likely to have been supported by declining capital market rates which enhanced the attractiveness of longer-term bank debt securities vis-à-vis similar government bonds. Furthermore, longer-term fixed-term deposits increased perceptibly again. The trend reduction in deposits redeemable at notice of over three months, which began in mid-2001, practically came to a standstill at the end of the quarter.

Bond yields in the euro area and the USA

Daily data



1 Weighted average of the yields on ten-year government bonds of all euro-area countries; GDP-weighted. — 2 Spread of seven to ten-year BBB-rated European corporate bonds over euro-area government bonds with a comparable maturity. Source: Merrill Lynch Indices.

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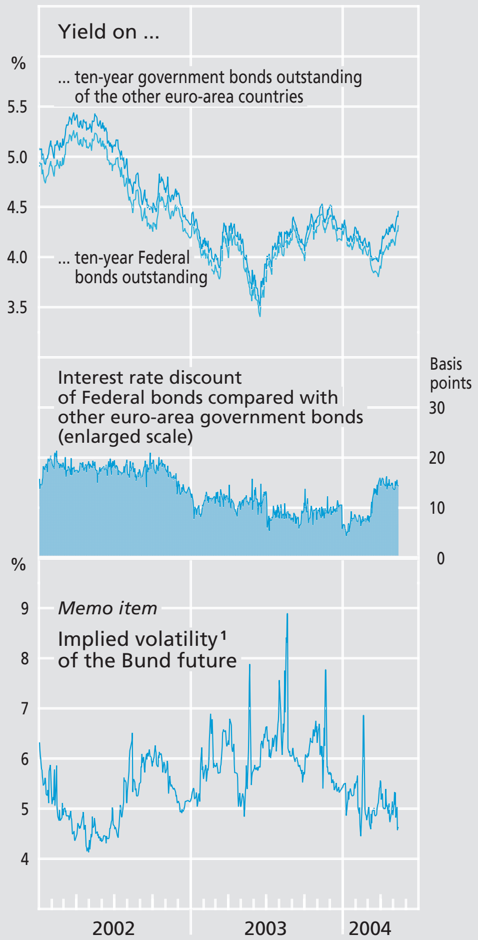
Securities markets

Financial markets – the impact of mixed economic expectations

Some uncertainty with respect to the sustainability of the global upturn depressed the basic optimistic mood in the financial markets. As a result, the protracted rise in share prices in the equity market came to a halt in March. Even the subsequent release of again more favourable economic data in the United States only boosted share prices temporarily.

Yields on Federal bonds and other euro-area government bonds

Daily data



1 Market expectation of future volatility derived from the prices of options on Bund futures.

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At the same time, in the light of expectations of a gradual end to the easy-money policy in the USA, capital market rates rose again, after having trended downwards in the previous months.

On balance, only a slight change in capital market rates

As this report went to press, ten-year euro-area government bonds were yielding at over 4⅓%, nearly ½ percentage point above their low in mid-March. Temporary doubts on the intensity of the US upturn and less favourable leading economic indicators on the European economy contributed to this low in March. As a result, both the business climate and consumer confidence in the euro area and in Germany became more gloomy. Moreover, in connection with the terrorist attacks in Spain in mid-March, uncertainty on the future price developments in the bond market rose temporarily. As an upshot, however, renewed confident economic expectations boosted bond market yield. However, the yield increase was more pronounced in the US market than in the euro area, meaning that the yield spread of long-term US government bonds vis-à-vis comparable euro-area bonds widened to ½ percentage point. Not only did more optimistic growth expectations play a role, comments by the US Federal Reserve Bank, which market participants interpreted as an indication of an upcoming interest rate swing, also contributed to this.

Yield discount on Bunds increases vis-à-vis discount on paper issued by other euro-area countries

By and large, the German market moved in sync with the developments of European capital market rates. However, the yield discount on ten-year bonds issued by the Federal Government vis-à-vis the average of the other euro-area government bonds has increased since mid-March to considerably more than 1⁄10 percentage point. This is also likely to have come as a result of portfolio shifts into highly liquid German government bonds as a "safe haven" following the attacks in Madrid.

Real interest rates in the euro area in line with long-term growth expectations

Surveys conducted on economic expectations for the next ten years show that at 1.8%, long-term inflation expectations have remained virtually unchanged. With long-term real interest rates of around 2¼%, these were largely in line with the long-term outlook for growth in the euro area.

Financing terms remain favourable on corporate bonds market

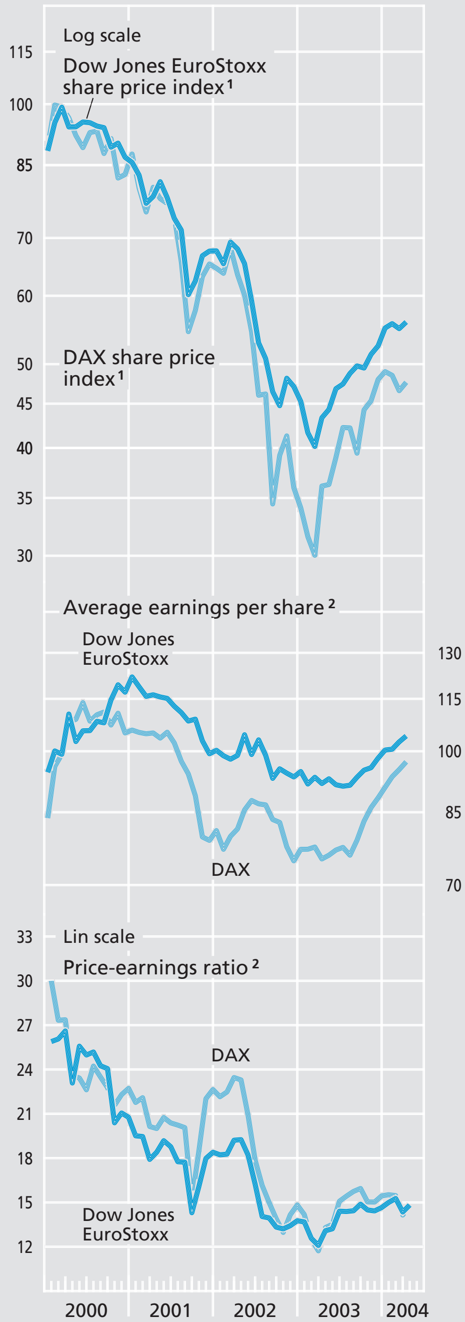
At the time this report went to press, the yield spreads in the corporate bond market for seven to ten-year bonds with a BBB rating were just under 90 basis points – a low level by historical comparison. There was only a temporary increase to just under 1 percentage point. This development is in line with the fall in share prices in March and the increasing uncertainty with respect to future share prices. Both factors exert significant influence on the valuation of corporate bonds (see *Monthly Report,* April 2004, page 25). The now favourable valuation is also being supported by an improvement in enterprises' credit ratings. In the first quarter the ratio of upgrades to downgrades by rating agencies rose further. The last time a similarly positive environment was observed was in the first half of 2000.

Losses in the equities market

Share price movements in the European stock markets reflected intervals of uncertainty with respect to the future of the economic recovery process. Following the terrorist attacks in Madrid in mid-March share prices actually fell considerably for a short time. By the end of the month, German and European equities, measured against the CDAX share price index and the Dow Jones EuroStoxx, had lost approximately 6% and 3% of their value respectively since the beginning of the year. In this context, German and other European telecommunications and technology shares – probably also due to portfolio shifts in favour of more defensive ones – suffered above-average price losses. At the same time,

Price movements and profit estimates for European and German public limited companies

Monthly data



1 March 2000 = 100; source: Deutsche Börse AG. — **2** Based on year-on-year I/B/E/S analyst estimates. Source: Thomson Financial Datastream.

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Investment activity in the German securities markets

€ billion

Item	2003 Oct to Dec	2004 Jan to Mar	2003 Jan to Mar
Bonds and notes			
Residents	18.6	54.4	35.5
Credit institutions	8.6	55.3	20.0
of which Foreign bonds and notes	13.4	23.4	2.7
Non-banks	10.0	– 0.9	15.5
of which Domestic bonds and notes	19.2	2.6	11.6
Non-residents	10.5	32.3	33.2
Shares			
Residents	– 9.4	– 2.0	– 3.7
Credit institutions	9.2	6.7	– 6.2
of which Domestic shares	7.0	7.4	– 3.5
Non-banks	– 18.6	– 8.7	2.5
of which Domestic shares	– 21.9	– 9.2	9.8
Non-residents	21.2	3.1	– 3.4
Mutual fund shares			
Investment in specialised funds	5.2	2.8	7.9
Investment in funds open to the general public	– 0.4	2.8	10.9
of which: Share-based funds	0.9	0.6	– 0.8

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share price uncertainty (measured by the implied volatility of stock options) rose as well as the risk premia demanded for investments in equities. Since then, however, the market has recovered somewhat again. On balance, however, the European equities markets remained below the levels seen at the start of the year.

Continued rise in earnings expectations …

In the period under review, the intermittent concerns about the future economic development and the geopolitical uncertainties did not have any impact on the assessment of enterprises' earnings outlook. The annual expected earnings for enterprises listed in the DAX have risen steadily since January by 7% and by just under 4% for enterprises listed in the Dow Jones EuroStoxx index. Despite prices swings the valuation level for both markets has remained nearly unchanged and is still below the historical average. An international comparison shows that, based on expected annual earnings, German and other European shares are – with a price-earnings ratio of 15.0 – valued at a relatively low level. The US enterprises reflected in the S&P 500 are valued at 17.1 and Japanese enterprises, measured by the MSCI Japan, are valued at 19.5.

… supports relatively favourable valuations

Sales and purchases of securities

Bond sales

The level of issuing activity in the German securities markets was influenced significantly by the financing needs of the public sector and banks' longer-term borrowing. In total, domestic borrowers issued debt securities to the value of €350 billion in the first quarter. After deducting redemptions and changes in issuers' holdings of their own bonds, €67 billion was raised. In addition, foreign bonds were sold for €20 billion net in the German market in the first quarter. Hence, total funds raised through the sale of domestic and foreign bonds and notes reached €86½ billion, compared with €29 billion in the last quarter of the past year.

Large issuing volume of public-sector bonds

Nearly half of the funds raised accrued to the public sector. This sector increased its bonded debt by €35 billion net following €12½ billion in the previous quarter. Three quarters of this consisted of issues by the Federal Government which expanded primarily its longer-term debt, including ten-year Federal bonds (€16 billion net) and thirty-year Federal bonds (€5 billion). The volume outstanding of fiveyear Bobls also increased by €5 billion. Two-year treasury notes raised €1½ billion while Federal savings notes were redeemed for 1½ billion net. In addition, one bond issued by the former Treuhand agency was redeemed for €4 billion in March. To increase the liquidity of the individual bonds, this borrower no longer issues debt securities in its own name but refinances itself in conjunction with the Federal Government since 1998.

Rise in borrowing by credit institutions

German credit institutions raised €34 billion in the German bond market between January and March 2004 after having raised €6½ billion in the previous quarter. Their favoured issuance vehicle was other bank debt securities, which brought in €21½ billion net. Their share in the overall volume of bank debt securities outstanding has increased almost steadily from over a one-fourth in the first quarter of 2000 to now more than one-third. To a significant degree, the performance of certificates linked to the performance of an underlying asset (for instance a share index) also contributed to this development. Bonds issued by specialised credit institutions raised €17 billion net and the volume of mortgage Pfandbriefe outstanding rose by €2½ billion. As in the previous period, public Pfandbriefe were redeemed in net terms. The volume of these mortgage bonds outstanding fell by €7 billion during the period under review.

Decline in funds raised by enterprises in the bond market

Despite still favourable financing costs in the corporate bond market, the volume of debt securities issued by resident enterprises declined by just under €2 billion in the first quarter. In the previous period, such debt securities were issued for €6 billion net. The volume of money market paper issued by resident enterprises remained virtually unchanged.

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

€ billion

Item	2004 Jan to Mar	2003 Jan to Mar
Deposits of domestic non-MFIs 1		
Overnight	+ 11.4	+ 3.9
With agreed maturities		
up to 2 years	– 18.1	– 13.8
over 2 years	+ 6.7	+ 8.2
At agreed notice		
up to 3 months	+ 2.6	+ 8.8
over 3 months	– 1.5	– 4.7
Lending		
to domestic enterprises and households		
Unsecuritised	– 5.0	+ 8.7
Securitised	+ 8.3	– 1.2
to domestic government		
Unsecuritised	+ 5.3	– 4.4
Securitised	+ 20.1	+ 20.5

***** As well as banks (including building and loan associations, but excluding the Bundesbank), monetary financial institutions (MFIs) here also include money market funds; see also Table IV.1 in the Statistical Section of the *Monthly Report*. — **1** Enterprises, households and government.

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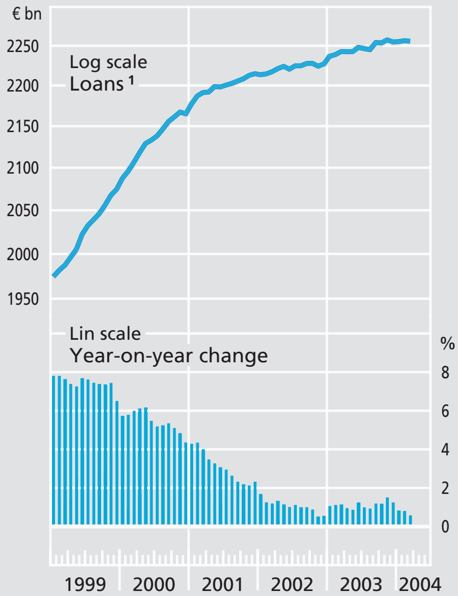
Domestic bonds and notes purchased mainly by credit institutions

German credit institutions were the principal purchasers in the German bond market in the first quarter of 2004. They added €55½ billion to their bond portfolios, having purchased merely €8½ billion in the previous quarter. Their main interest was in foreign bonds and notes (€23½ billion) and public-sector bonds (€20½ billion). In net terms, foreign investors increased their holdings in German debt securities by €32½ billion, adding mainly public sector paper to their portfolios (€18½ billion). By contrast, domestic non-banks, which invested €2½ billion (net) in the German bond market, focused only on paper issued by private borrowers. At the same

Loans to domestic enterprises and households

Seasonally adjusted



1 End of month; adjusted for statistical changes.

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time, they reduced their holdings in foreign bonds and notes by €3½ billion.

Lower volume of funds raised in the equity market

Issuing activity in the German equity market declined in the first quarter. Domestic enterprises placed new shares with a market value of only €1½ billion. In the previous quarter, the volume of shares outstanding had increased by 6½ billion, mainly due to a capital increase by an insurer and a big bank. Two new issues, which had been originally planned for the period under review, were cancelled at short notice. This was probably due, at least in part, to the mixed mood in the equities market mentioned earlier. However, a number of enterprises have announced that an IPO would take place over the course of the year.

Equities purchased by credit institutions and non-banks

In the January to March period, domestic credit institutions and foreign investors purchased German equities worth €7½ billion net and €3 billion net respectively. By contrast, domestic non-banks reduced their holdings of domestic shares by €9 billion. The foreign equities portfolio of domestic non-banks and credit institutions changed only slightly (€½ billion and -€½billion respectively).

Increased investment in mutual fund shares

Sales of both domestic and foreign mutual fund shares picked up in the first quarter of 2004 (€12½ billion). Domestic funds sold shares for €5½ billion, accruing in equal parts to funds open to the general public and to specialised funds tailored to the needs of institutional investors. Of the funds open to the general public, investors favoured open-end real estate funds (€2 billion), followed by bond-based funds (€1 billion) as well as share-based funds and mixed funds (€½ billion each). By contrast, money market funds, as in the previous quarter, redeemed shares (€1 billion). Hence it seems that the gradually increasing preference for higher-interest-bearing investment vehicles already apparent in the previous quarter, continued.

Deposit and lending business of German banks with domestic customers

Liquidity preference increases again considerably

Much the same as in the rest of the euro area, demand in the area of domestic deposits in the period under review focused primarily on short-term bank deposits. There were signs in the fourth quarter of 2003 suggesting that as investors became more confident on the economy they began to prefer riskier and less liquid forms of investment: in the first quarter of 2004, however, a mixture of unfavourable and unsettling factors shifted investors' preference again towards liquidity. Moreover, the intermediate decline in capital market rates meant lower opportunity costs for cash holdings. In such an environment, quickly available and safe bank deposits were once again an attractive form of investment.

Sharp increase in overnight deposits

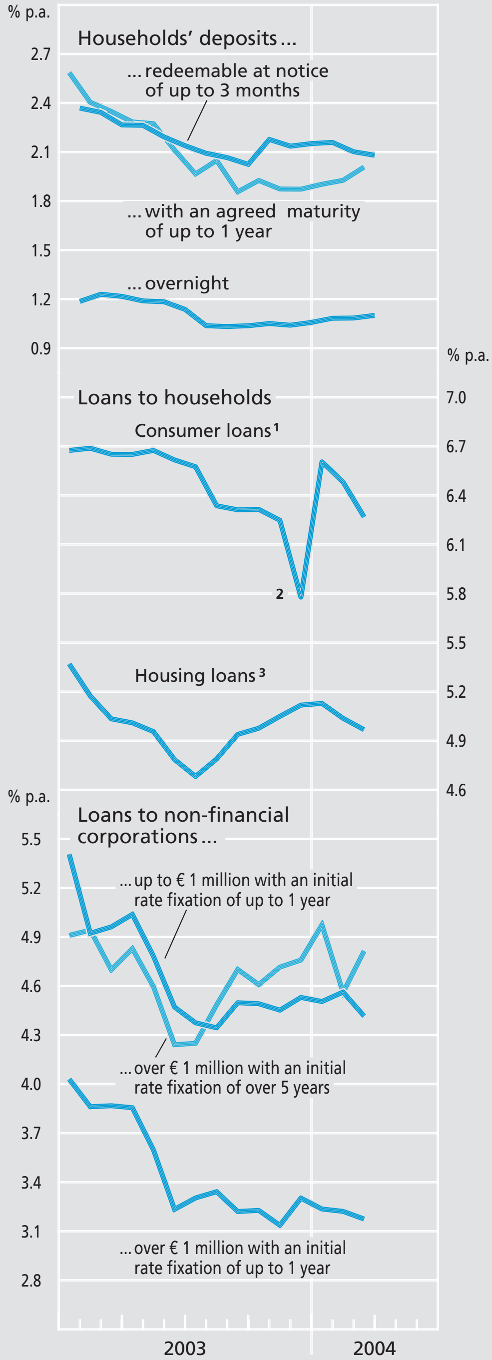
Overnight deposits benefited particularly from the further increase in demand for liquid bank deposits. In the first quarter, these were built up markedly, having been reduced considerably in the previous quarter. Somewhat higher interest rates and considerable shifts away from short-term time deposits, which in the period under review were particularly the case with non-financial enterprises, also had an impact. In addition, other financing institutions which are not attributed to the banking sector expanded their sight deposits sharply in January after having reduced them considerably in December – presumably for accounting reasons.

Short-term time deposits fall again sharply...

The decline in short-term time deposits since the end of 2001 (with an agreed maturity of up to two years) accelerated in the period under review. Both non-financial and other financing institutions reduced these deposits. In addition, households also reduced their short-term time deposits further, which was likely due to the ever-lower yield advantage of such deposits vis-à-vis overnight money. In addition to overnight deposits, short-term savings deposits (with an agreed notice period of three months) also benefited from the low-interest environment. These deposits

Bank interest rates in Germany

New business



1 With an initial rate fixation of over 1 year and up to 5 years. — 2 Decline owing to special effect. — 3 With an initial rate fixation of over 5 years and up to 10 years.

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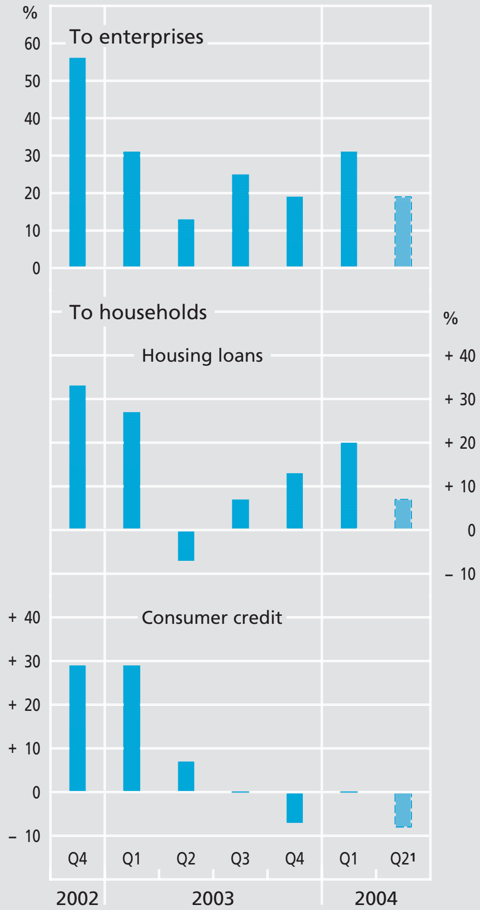
Bank lending survey:
Changes in credit standards*



* Difference between the sum of the percentages for “tightened considerably” and “tightened somewhat” and the sum of the percentages for “eased somewhat” and “eased considerably”. — 1 Expectations for Q2.

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... while short-term savings deposits increased

were also increased considerably in the period under review. Their increase, however, was by far unable to offset the decline in short-term time deposits.

Overall increase in longer-term bank deposits

Of the longer-term bank deposits only the longer-term time deposits (with a maturity of over two years) continued to grow in the period under review. Employed persons and especially insurers were the main depositors here. The longer-term savings deposits (with an agreed notice period of over three months) continued to decline in the period under review, although the decline was again weaker than in the previous quarter. Even so, since the start of the interest-lowering period in the spring of 2001, these savings deposits have been reduced by nearly 30%. The markedly lower yield advantage vis-à-vis short-term savings deposits is likely to have been one of the main reasons for this.

Strong increase in lending to the public sector

In the period under review, the credit expansion in Germany varied greatly according to sector. While lending to the private sector grew only slightly, loans to the public sector surged in seasonally adjusted annual terms by 14½% in the first quarter. This increase was attributed mainly to a rise in holdings of domestic government paper. In the previous year these holdings were also increased unusually strongly in the first quarter but were reduced somewhat in the subsequent quarters again. Loans to the public sector also increased considerably in the first quarter. The Federal government expanded strongly its short-term borrowing from German banks particularly in March. At the same time, however, it also increased sharply its deposits held with German banks.

Increase in securitised lending ...

In the first quarter, banks increased their securitised lending to the domestic private sector, owing particularly to corresponding securities purchases. Hence, banks in Germany increased sharply their holdings in equities and other dividend-bearing paper issued by domestic enterprises. However, since the shares were mainly acquired in the secondary market, banks' purchases did not result in a corresponding cash flow to the issuing enterprises. In the first quarter in Germany, private non-banks received nearly no new money from unsecuritised borrowing either. Banks' claims arising from advances and loans to enterprises and households in Germany remained practically unchanged in this period.

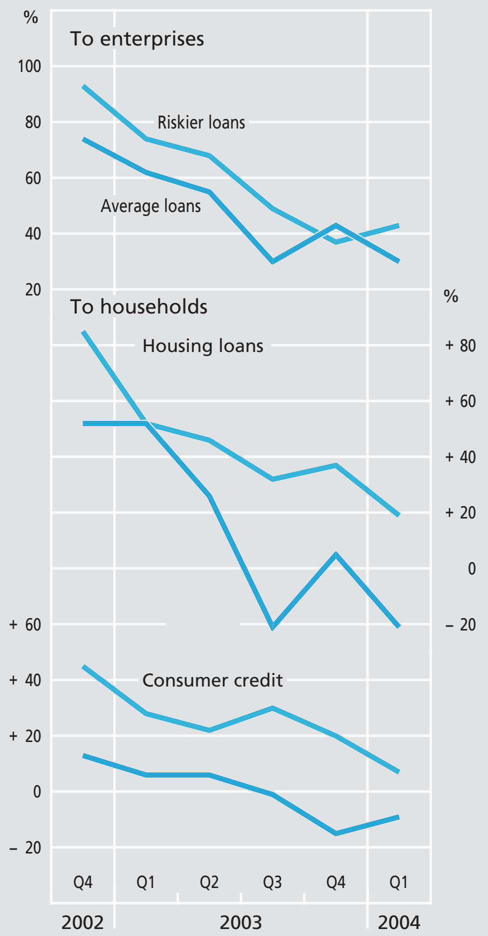
... but only a slight increase in loans to the private sector

The ongoing sharp reduction in short-term lending largely offset the increase in longer-term lending, which grew by a seasonally adjusted annualised rate of 1½% in the period under review. In the light of low long-term interest rates, private borrowers have thus secured favourable financing terms in the longer term. All major borrower groups are likely to have taken advantage of these conditions, although the increase in longer-term housing loans was again low in the period under review.

Weak credit demand and somewhat more restrictive credit standards for loans to enterprises and housing loans

The weak credit development in Germany is still essentially a result of lower credit demand. For example, in the April edition of the Bank Lending Survey in the Eurosystem[1] banks report on lower demand from enterprises and for housing loans now that the anticipatory effect from the past year as a result of the discussion on the grant to home buyers has run its course. To a certain degree, the credit development is also likely to have been influenced by supply side factors. In the first quarter of 2004, banks surveyed in Germany were again inclined to further tighten slightly their lending guidelines and their credit standards for loans to enterprises. According to respondents, this reflected partly an increase in capital costs and a more critical assessment with respect to industry and

Bank lending survey:
Changes in loan margins*



* Difference between the sum of the percentages for "tightened considerably" and "tightened somewhat" and the sum of the percentages for "eased somewhat" and "eased considerably".

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enterprise-specific risks as well as the value of collateral. The restrictive tendency witnessed in the previous quarter with respect to housing loans strengthened somewhat as well. Some further tightening for loans to enterprises is expected in the second quarter of

1 See Deutsche Bundesbank, Results of euro-area bank lending survey, *Monthly Report,* June 2003, pp 67ff. The aggregate survey results for Germany can be found under http://www.bundesbank.de/volkswirtschaft/vo_veroeffentlichungen.php.

2004; respondent institutions do not expect noteworthy changes in their credit standards for loans to households (see chart on page 50).

Ongoing trend towards wider margins – collateral gaining in importance again

The trend continued towards risk-differentiated spreads, particularly for housing loans. In some cases, margin spreads for riskier loans even widened somewhat, while average loans benefited from an initial narrowing of margin spreads. Riskier loans to enterprises were also more strongly affected by broader margin spreads than was the case for average loans. By contrast, the conditions for consumer loans remained largely unchanged (see chart on page 51). With regard to other lending conditions, the respondent banks also indicated that they were occasionally applying somewhat stricter criteria to loans to enterprises in respect of collateral as well as to the lending ratio for housing loans.

No indication of additional tensions in the credit market

Compared with the rest of Europe, the German survey results indicated a somewhat more restrictive trend on the credit supply side in the area of loans to enterprises and housing loans than the euro-area average. German banks also assessed credit demand as somewhat weaker.[2] On the whole, the interplay between somewhat more restrictive changes on the credit supply side and, at the same time, weaker activity on the credit demand side, is likely not to have resulted in additional tension on the credit market.

2 See European Central Bank, Monthly Bulletin, May 2004, pp 16ff.