Monetary policy and banking business

Interest rate policy and the money market

Eurosystem interest rates remain unchanged

Over the past three months, the Governing Council of the ECB has again followed its monetary policy strategy and left the central bank interest rates unchanged. The Eurosystem's main refinancing operations in the form of variable rate tenders therefore continue to be subject to a minimum bid rate of 4%, while the Eurosystem charges interest of 5% for accessing the marginal lending facility and pays 3% on the deposit facility. Given the continued tensions on money and credit markets and the marked deterioration in the price climate, the firm anchoring of longer-term inflation expectations continues to be the main challenge facing monetary policy makers.

Money market risk premiums rise again

The consequences of financial market turbulence continue to determine the mood in the euro money market, especially when it comes to longer maturities. Following recent reports from European and US banks of write-downs on their exposures in structured loans, the risk premiums included in unsecured money market interest rates have increased – considerably in some cases – since March 2008 after dropping significantly at the start of the year. The spread between the unsecured three-month EURIBOR and the collateralised three-month EUREPO rose from around 0.4 percentage point to around 0.8 percentage point between the end of February and the end of April and was therefore only around 0.1 percentage point below the record high of December 2007.

Money market management and liquidity needs

In the three reserve maintenance periods between 16 January and 15 April 2008, euro-area credit institutions' need for central bank liquidity determined by autonomous liquidity factors remained almost unchanged in net terms. The demand for liquidity from banknotes in circulation declined by €6.5 billion. This is attributable to the sharp decline of €16.5 billion in demand for banknotes in the January-February 2008 maintenance period after the marked increase over the Christmas period. If the net foreign reserves and the other factors are taken together, a move which eliminates liquidity-neutral valuation effects, there is likewise a decline in the liquidity needs over the three periods (€17.5 billion in total). This was caused by the continued purchase of euro-denominated financial assets unrelated to monetary policy and by the disbursements of central bank profits, which have an effect on liquidity, including the Bundesbank profit of around €4.3 billion paid on 11 March. By contrast, liquidity needs arising from general government deposits with the Eurosystem rose markedly by a net €23.8 billion.

Also during the period under review, the Eurosystem pursued the course set in August 2007 of supplying the credit institutions with generous amounts of liquidity over almost the entire maintenance period to enable them to fulfil their minimum reserve requirements early and, therefore, to hold the EONIA near to the minimum bid rate and to contribute to a normalisation of the money market. Even so, the Eurosystem did not make more liquidity available to the banks than they needed to meet the minimum reserve requirement, which increased during the reporting period. Consequently, the Eurosystem shifted the emphasis of its open market transactions more heavily into the longer-term area once again. Contributory factors to this in the reporting period were not only the extension of two supplementary three-month refinancing operations but also the implementation of an additional tender with, for the first time, a maturity of six months.

In the January-February maintenance period, the ECB maintained the course which it had set in the preceding months, allotting liquidity volumes in main refinancing operations which were substantially above the benchmark. In the first main refinancing operation (MRO) in the maintenance period which began on the 16 January, the above-benchmark allotment was €25.0 billion. During the maintenance period, the ECB reduced the amounts above the benchmark to €4.0 billion in the last MRO. On almost all days during this period, with the exception of the last day in January, the EONIA was close to the minimum bid rate of 4.00% and therefore fulfilled the aim of liquidity management. After a liquidity-absorbing fine-tuning operation with a volume of €16.0 billion on the last day of the maintenance period, however, the EONIA increased again to 4.10%.

In the subsequent maintenance period of February-March, the main refinancing operations were once again characterised by generous but successively decreasing amounts above the benchmark. The ECB reduced the above-benchmark allotments in stages from €20.0 billion in the first MRO of the period to €4.0 billion in the last. The EONIA spread (difference between the EONIA and the minimum bid rate) was, until shortly before the end of the maintenance period, 5 basis points at the most, showing an easing in the short-term market rates. On the penultimate day of the period, however, the EONIA increased markedly. The liquidity-providing fine-tuning operation carried out by the ECB on the last day of the maintenance period with a volume of €9.0 billion was, however, unable to prevent the EONIA increasing significantly to 4.23%.

Banks' supply of liquidity over the Easter holidays was the most significant issue of the March-April maintenance period. In comparison with the main refinancing operations in the preceding periods, in this period, the ECB deviated from its earlier strategy of a gradual reduction in above-benchmark amounts. In order to provide a generous supply of liquidity before Easter, the banks were allotted €25.0 billion more than the calculative liquidity need (ie the benchmark) in each of the first two MROs. Additionally, the ECB met the increased demand for central bank money by means of a liquidity-providing fine-tuning operation with a volume of €15.0 billion and a maturity which extended over the Easter holidays. However, these measures were not enough to bring the EONIA, which had climbed to 4.19% before Easter, back down to the level of the minimum bid rate. In the first MRO after the Easter holidays, the ECB increased the above-benchmark allotment to €50.0 billion in order to ensure sufficient liquidity at the end of the month (which was also the end of the quarter). An additional fine-tuning operation on the last day of March supported this aim. Even so, these measures were not able to reduce the EONIA by the desired amount, and, on 31 March, the EONIA was again at 4.16%. At the beginning of April, however, the EONIA spread decreased markedly and generally stood at less than 6 basis points during the remainder of the maintenance period. On the last day of the period, the EONIA dropped markedly once again to 3.78% after a liquidity-providing fine-tuning operation with a volume of €21.0 billion had been underbid by €6.1 billion.

At the start of the April-May maintenance period the EONIA again hovered at rates around the minimum bid rate of 4.00%.

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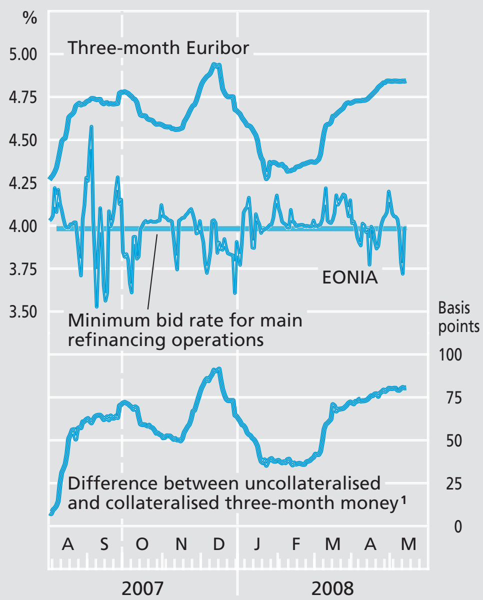
Liquidity policy measures ...

As in the previous months, the Eurosystem countered the turbulence on the money market with various liquidity policy measures. It provided banks with generous additional liquidity at the beginning of the reserve maintenance periods and thus enabled banks to meet their minimum reserve requirements early (frontloading). The overnight interest rate (EONIA) was also stabilised close to the minimum bid rate for main refinancing operations thanks to additional fine-tuning operations with different maturities. Furthermore, the Eurosystem supported banks' longer-term liquidity arrangements by focusing central bank lending to a greater extent on three-month and recently also six-month maturities.

... do not signal a change in monetary policy

Continuing additional three-month tender operations and introducing the new six-month transaction did not increase the total refinancing volume at the corresponding amount, however. This underlines the special role of liquidity policy operations as a means of strengthening the smooth functioning of the euro money market, which should not be mistaken for more expansionary European monetary policy.

Money market interest rates in the euro area



1 Three-month Euribor less three-month Eurepo.

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Monetary developments in the euro area

Monetary growth remains strong

Monetary development in the first quarter of 2008 was again characterised by strong growth in money holdings in the euro area. At a seasonally adjusted annualised growth rate of 8½%, however, it was down somewhat on the two-digit growth rates of the two previous quarters. Of all the components of M3, financial investments remunerated close to market rates, in particular, have increased considerably, while the highly liquid monetary components of M1 went up only moderately in the first quarter and holdings of overnight deposits actually stagnated.

Pace of growth in private-sector loans unchanged ...

Private-sector loans granted by banks in the euro area were again the main source of money creation in the first quarter, although they also grew somewhat less strongly than in previous quarters. The increase in bank holdings of securities from private issuers in the euro area, which are included in the total number of outstanding bank credits, was the only element to reduce its growth rate, however. Seasonally adjusted and annualised growth in securities holdings was just 6½% in the first quarter compared with 39½% be-

Factors determining bank liquidity *

€ billion; changes in the daily averages of the reserve maintenance periods vis-à-vis the previous period

Item	2008 16 Jan to 12 Feb	2008 13 Feb to 11 March	2008 12 March to 15 April
I Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors			
1 Banknotes in circulation (increase: –)	+ 16.5	– 1.5	– 8.5
2 General government deposits with the Eurosystem (increase: –)	– 5.3	– 8.0	– 10.5
3 Net foreign reserves 1	+ 9.8	– 10.3	+ 5.8
4 Other factors 1	– 5.7	+ 14.3	+ 3.6
Total	+ 15.3	– 5.5	– 9.6
II Monetary policy operations of the Eurosystem			
1 Open market operations			
(a) Main refinancing operations	– 81.9	+ 7.5	+ 0.2
(b) Longer-term refinancing operations	– 0.3	– 0.0	+ 10.1
(c) Other operations	+ 67.8	+ 0.9	+ 1.9
2 Standing facilities			
(a) Marginal lending facility	– 0.1	– 0.1	+ 0.0
(b) Deposit facility (increase: –)	+ 0.7	+ 0.1	– 0.3
Total	– 13.8	+ 8.4	+ 11.9
III Change in credit institutions' current accounts (I + II)	+ 1.5	+ 2.9	+ 2.2
IV Change in the minimum reserve requirement (increase: –)	– 1.8	– 2.9	– 2.3

* For longer-term trends and the Deutsche Bundesbank's contribution, see pages 14* and 15* of the Statistical Section of this Monthly Report. — 1 Including end-of-quarter valuation adjustments with no impact on liquidity.

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tween October and December of last year when, among other things, one-off effects in connection with the financing of the acquisition of a large European bank by an international banking syndicate had boosted banks' securities holdings in the euro area. By contrast, private-sector loans rose by a seasonally adjusted, annualised rate of 10% in the reporting period, the same amount as in the closing quarter of 2007.

... but varies from sector to sector

Strong growth was again recorded in unsecuritised loans to non-financial corporations. Not least owing to vigorous loan growth in Germany, the – in some cases – considerable decline in loans to enterprises, especially in those euro-area countries confronted with a substantial deterioration in economic outlook, did not impact the corresponding aggregate for the entire euro area. But even if Germany is excluded, there is currently no evidence of a serious decline in loans to enterprises in the euro area. Loans to other financial intermediaries also increased significantly, a development which was partly due to risk-shielding operations in connection with the turbulence on the international financial markets. Conversely, loans to households continued to fall. Fewer housing loans, in particular, were granted compared with the corresponding periods in earlier years. As well as shrinking demand for loans owing to the changed economic situation and outlook in some euro-area countries, the slower growth in housing loans is also attributable to the stricter credit standards applied by banks to cover the elevated risks.

Open market operations of the Eurosystem *

Value date	Type of transaction 1	Maturity in days	Actual allotment in € billion	Deviation from the benchmark in € billion	Marginal rate/fixed rate %	Allotment ratio %	Weighted rate %	Cover ratio 2	Number of bidders
16.01.08	MRO	7	190.5	25.0	4.16	28.53	4.21	1.27	281
23.01.08	MRO	7	175.5	17.0	4.16	88.19	4.19	1.34	276
30.01.08	MRO	7	167.5	10.0	4.18	79.02	4.20	1.51	264
31.01.08	LTRO	92	50.0	–	4.21	38.94	4.33	1.96	151
06.02.08	MRO	7	161.5	4.0	4.17	45.03	4.20	1.39	226
12.02.08	FTO (–)	1	– 16.0	–	4.00	54.88	–	1.82	22
13.02.08	MRO	7	187.5	20.0	4.10	54.31	4.18	1.19	229
20.02.08	MRO	7	178.0	15.0	4.10	78.17	4.15	1.27	262
21.02.08	S-LTRO	91	60.0	–	4.15	29.71	4.26	1.84	105
27.02.08	MRO	7	183.0	10.0	4.10	15.83	4.15	1.27	260
28.02.08	LTRO	91	50.0	–	4.16	39.21	4.23	2.19	165
05.03.08	MRO	7	176.5	4.0	4.11	96.39	4.14	1.36	264
11.03.08	FTO (+)	1	9.0	–	4.13	15.00	4.14	5.01	32
12.03.08	MRO	7	209.5	25.0	4.12	24.55	4.16	1.24	298
13.03.08	S-LTRO	91	60.0	–	4.25	22.13	4.40	2.21	139
19.03.08	MRO	7	202.0	25.0	4.16	19.38	4.20	1.46	336
20.03.08	FTO (+)	5	15.0	–	4.13	11.96	4.20	4.39	44
26.03.08	MRO	7	216.0	50.0	4.23	19.11	4.28	1.40	301
27.03.08	LTRO	91	50.0	–	4.44	77.88	4.53	2.63	190
31.03.08	FTO (+)	1	15.0	–	4.06	73.65	4.13	2.05	25
02.04.08	MRO	7	150.0	35.0	4.21	2.65	4.25	1.89	306
03.04.08	S-LTRO	189	25.0	–	4.55	27.77	4.61	4.12	177
09.04.08	MRO	7	130.0	5.0	4.23	53.72	4.24	1.90	295
15.04.08	FTO (–)	1	– 14.9	–	4.00	100.00	–	1.00	7

* For more information on the Eurosystem's operations from 14 November 2007 to 15 January 2008, see Deutsche Bundesbank, Monthly Report, February 2008, p 25. — **1** MRO: main refinancing operation, LTRO: longer-term refinancing operation, S-LTRO: supplementary longer-term refinancing operation, FTO: fine-tuning operation (+: liquidity providing operation, –: liquidity absorbing operation). — **2** Ratio of total bids to the allotment amount.

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Little growth in longer-term investment at banks

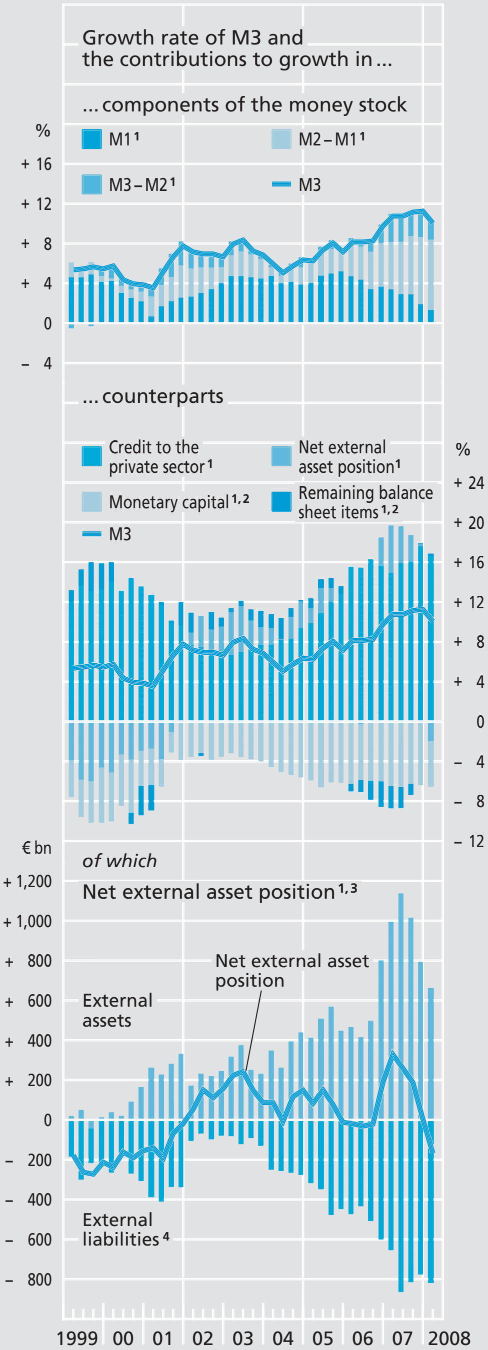
After increasing very sharply in the previous quarter, monetary capital formation in the euro area was relatively low in the first quarter, thus boosting monetary growth within the context of the consolidated balance sheet. On a seasonally adjusted and annualised basis, banks' longer-term liabilities rose by just over 1½%, the lowest level since mid-2002. Growth in longer-term time deposits, in particular, slowed dramatically, possibly in connection with the considerable decline in banks' securitisation activity and the ensuing slower increase in credit institutions' liabilities to securitisation vehicles. Furthermore, as in the previous quarter, holdings of longer-term bank debt securities outside the European banking sector increased only slightly. The temporary dip in sales in some sub-segments as well as relatively high spreads on bank debt securities may have played a role here. In the period under review, the weak growth in the monetary capital, which comprises all liabilities not recognised as M3 in the consolidated balance sheet of the banking system, was also caused by lower allocations of capital and reserves. While this position increased at an annualised rate of 28% in the fourth quarter of 2007, the growth rate was just 6% in the first quarter of 2008 – probably also owing to the financial market turbulence.

Another significant decline in banks' net external asset position

As in the fourth quarter of 2007, net outflows of funds from the non-banking sector of the euro area to foreign countries had a negative effect on monetary growth in the first quarter of 2008, which was reflected in

Components and counterparts of the money stock in the euro area

Seasonally adjusted, quarterly



1 Calculated from the changes cumulated over 12 months. — 2 Taken in isolation, an increase curbs M3 growth. — 3 Not seasonally adjusted. — 4 Increase: –.

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statistics as a drop in the net external asset position of euro-area banks.

Monetary analysis continues to show inflation risks

Although monetary dynamics in the euro area slowed somewhat between January and March, the price risks associated with monetary development remain high. Longer-term inflation forecasts based on monetary indicators remain well above the limit defined by the Governing Council as conducive to price stability. Despite the fact that monetary growth may have received renewed momentum from the continued financial market turbulence, and therefore overstated the longer-term monetary growth trend relevant to stability policy, monetary growth, which remains strong and is driven mainly by the large volume of lending to non-financial enterprises, continues to give cause for concern.

Deposit and lending business of German banks with domestic customers

Less demand for short-term bank deposits

After continued strong growth in recent quarters, seasonally adjusted, annualised growth in bank deposits in Germany decreased from 9% in the fourth quarter of 2007 to 4% in the first quarter of 2008. This decline is attributable to short-term bank deposits, which halved from just under 13% in the previous quarter to 6½% in the period under review. Highly liquid overnight deposits actually stagnated after decreasing slightly in the fourth quarter of 2007. Moreover, short-term savings deposits were cut again. By contrast, short-term time deposits (with an agreed maturity of up to two years) remunerated at market rates grew exceptionally strongly at an annualised rate of just over 30%, even if this pace of growth was much less than in the previous quarters.

Reduction in longer-term bank deposits

The considerable reduction in monetary capital formation in the euro area, which tended to stimulate monetary development, is also reflected in the development of longer-term bank deposits in Germany, which actually fell in the first quarter of 2008. As with short-term savings deposits, this decline affected longer-term savings deposits (with an agreed period of notice of over three months), which were topped up considerably in the previous year. By contrast, longer-term time deposits (with an agreed maturity of over two years) increased slightly. While insurance companies, which are typically the largest investor group in this segment, invested less in these deposits than is usual in the first quarter, other financial intermediaries invested more capital in deposits with longer maturities at domestic banks.

Robust growth in private-sector loans

Although, in the first quarter of 2008, the upturn in lending by German banks to domestic customers did not continue at the remarkable pace of the last quarter of 2007, newly issued private-sector loans again increased at a seasonally adjusted, annualised rate of 3% in the period under review after years of near stagnation. Producing enterprises, in particular, took out new loans from German banks. This is another indication of robust investment activity in Germany. Domestic households, by contrast, reduced their net debt arising from housing and other loans. Loans to general government also decreased significantly, as in the previous quarter. They fell at a seasonally adjusted, annualised rate of just over 8%. Bank holdings of public securities, on the other hand, rose slightly. German banks also purchased securities from private issuers for the first time in a year.

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

€ billion

Item	2008 Jan to Mar	2007 Jan to Mar
Deposits of domestic non-MFIs 1		
Overnight	+ 0.4	+ 0.3
With agreed maturities		
of up to 2 years	+ 14.6	+ 14.3
of over 2 years	+ 3.2	+ 2.7
Redeemable at agreed notice		
of up to 3 months	– 8.5	– 13.3
of over 3 months	– 3.1	+ 5.3
Lending		
to domestic enterprises and households		
Unsecuritised	+ 30.9	+ 20.4
Securitised	+ 11.2	+ 4.6
to domestic government		
Unsecuritised	– 9.8	– 11.0
Securitised	+ 6.7	+ 7.1

* 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 excluding central government.

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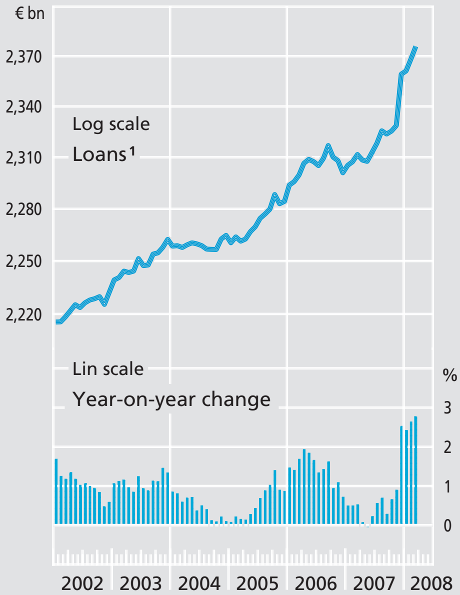
German banks offer different lending policies to borrowers

Contrary to fears, the above-mentioned data from banking statistics do not indicate major constraints in credit availability in the private sector as a result of the tensions on the international money and credit markets. This is also confirmed by the German results of the Bank Lending Survey.[1] The banks surveyed again applied slightly stricter standards for is-

1 Starting with the April round of surveys, the size of the German sample of the Bank Lending Survey for the euro area was increased from 17 to 30 institutions. This bigger sample makes the information gathered more representative, not least because it better reflects developments in the German banking industry in recent years.

Loans to domestic enterprises and households

Seasonally adjusted



1 End of month; adjusted for statistical changes.

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suing loans to enterprises in the first quarter of 2008 and, on balance, increased their margins for both average and riskier loans to enterprises. Loans to large firms were affected more in both cases. However, the adjustments appear to have been much less restrictive than they were in the euro area overall. Households were less affected by the stricter lending conditions as a whole. The banks surveyed claim to have increased only their margins for riskier consumer and housing credit, while credit standards for these loans were generally relaxed further and the margins for average loans were narrowed.

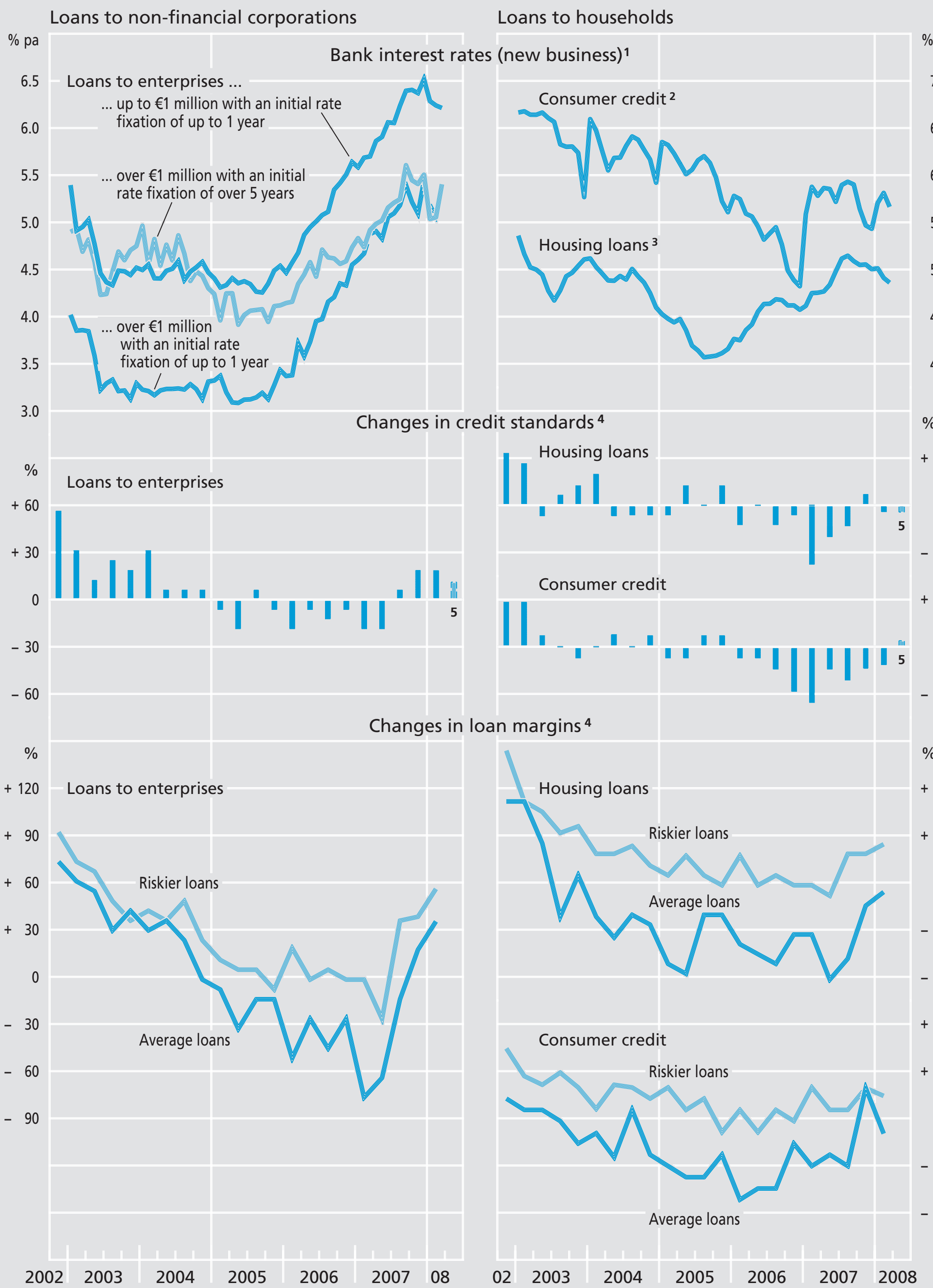
Effects of financial market turbulence on banks' lending policy

As in the previous quarter, the scope of the survey was extended to include a number of additional questions on the isolated effect of financial market turbulence on lending policy. In conjunction with the standard questions, the information provided by survey participants continues to indicate that tension on the financial markets has primarily affected commercial banking business and acquisition financing for large enterprises, in particular, while private customers have been less affected. The same effects are likely to prevail in future. These results are in line with the various surveys of enterprises conducted in the spring of this year and according to which small and medium-sized enterprises, in particular, did not complain of a noticeable deterioration in financial conditions.

Bank interest rates mainly down in first quarter of 2008

Reporting institutions reduced the price of their loans – with the exception of consumer credit – in the first quarter of 2008, thereby following the financial market trend. At the end of the period under review, institutions were therefore demanding interest of between 5.4% and 6.2% for short-term loans to enterprises and between 5.1% and 5.4% for long-term loans to enterprises, depending on the size of the loan. The conditions for private housing loans with an interest rate fixation period of over ten years were 4.9% at the end of the first quarter, compared with 5.0% at the end of 2007. On the banks' liability side, interest rates also fell in the first quarter with the exception of overnight deposits, which were remunerated at a slightly higher rate compared to the preceding quarter, thus partially mirroring the development of overnight conditions on the money market. Longer-term time deposits, in particular, were remunerated at tangibly less in the first quarter. With regard to the future development of banks' interest rates, how-

Banking conditions in Germany



1 According to harmonised MFI interest rate statistics. — 2 With an initial rate fixation of over 1 year and up to 5 years. — 3 With an initial rate fixation of over 5 years and up to 10 years. — 4 According to Bank Lending Survey; percentage difference between the numbers of respondents reporting “tightened considerably” and “tightened somewhat” and the numbers of respondents reporting “eased somewhat” and “eased considerably”. — 5 Expectations for 2008 Q2.

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"Traces" of the financial market turbulence in the financial accounts

The persistent turbulence in the global financial markets since August of last year has, among other things, led to tensions in the money market, caused share prices to fall and impacted adversely on bank balance sheets. Data on the aggregate financial flows for 2007 are now also available. These show that the individual sectors made sizeable shifts in their portfolios, especially in the second half of the year. Overall, the availability of funds is unlikely to have been affected by this, however.

Borrowing

According to the financial accounts, financial investment and borrowing moved in opposite directions last year. There was a sharp rise in financial investment by the non-financial sectors, while their demand for financing showed a marked fall. The latter amounted to just under €100 billion, compared with more than €140 billion in 2006. Even though the year-on-year decline in the demand for financing was more pronounced in the second half of 2007 than in the first six months, this development was not due to supply-side factors in the wake of the financial market turmoil. In fact, a sectoral analysis shows that this was primarily attributable to the consolidation measures of general government. Government borrowing in 2007 amounted to just €9 billion in net terms, which was around €40 billion less than in 2006.

Households, too, played their part in the decline in the demand for funds; at €18 billion in 2007, they reduced their debt by around €10 billion more than in 2006. Net repayments, which were spread throughout the year, were made not only on loans for consumption and commercial purposes – as had been the case in 2006 – but also, and for the first time, on loans for house purchase. This development is ultimately a reflection of the fact that households' propensity to consume and invest had been subdued for a long time and is therefore unlikely to be due to the financial market turbulence. In actual fact, the banks made it easier to gain access to new loans. According to the Bank Lending Survey, credit standards for households were, on the whole, eased somewhat in the second half of 2007.

Unlike in the case of government and households, non-financial enterprises' external financing requirements rose in 2007 – to just under €110 billion, compared with roughly €100 billion in the previous year. Demand for bank loans was particularly buoyant. Loans amounting to €55 billion on balance were taken up from domestic and foreign banks, which was about twice as much as in 2006. Borrowing took place predominantly in the second half of 2007. In line with the quite dynamic growth in investment in machinery and equipment, longer-term loans, too, were in significantly heavier demand.

In contrast to earlier years, other financial credits, which are granted mainly by foreign firms to group affiliates, played no more than a subordinate role in 2007, especially in the second half of the year. This was probably due to the fact that borrowing through bond issues by foreign financing subsidiaries, which often underlies such intra-group and tax-motivated loans, has become more difficult as a result of the problems in the financial markets. No such development was to be noted in the domestic capital market, however. By selling debt securities and equity, the producing enterprises procured funds amounting to €40 billion in 2007, which was roughly as much as in 2006. Furthermore, there were no significant differences in the inflow of funds between the first and second half of the year.

Financial investment

While the non-financial sectors' financial investment fell away markedly following the slump in share prices in 2000, the financial market turbulence of 2007 scarcely affected its scale. Nevertheless, as was the case in 2000, there were considerable structural changes in the investment behaviour of individual sectors. The sharp increase in financial investment by the non-financial sectors in 2007 was due mainly to the activities of producing enterprises, which built up their new financial assets by just under €60 billion

1 See Deutsche Bundesbank, The economic situation of small and medium-sized enterprises in Germany since 1997, Monthly Report, December 2006, pp 35-66.

to €157 billion. These consisted essentially of cross-border investment and – especially in the second half of the year – bank deposits. By contrast, debt securities were sold on a considerable scale in net terms. While the sale of money market paper was probably also prompted by the uncertainty in the wake of the financial market turbulence, the scaling-back of bond market investment has to be seen more in connection with the financing of external corporate growth.

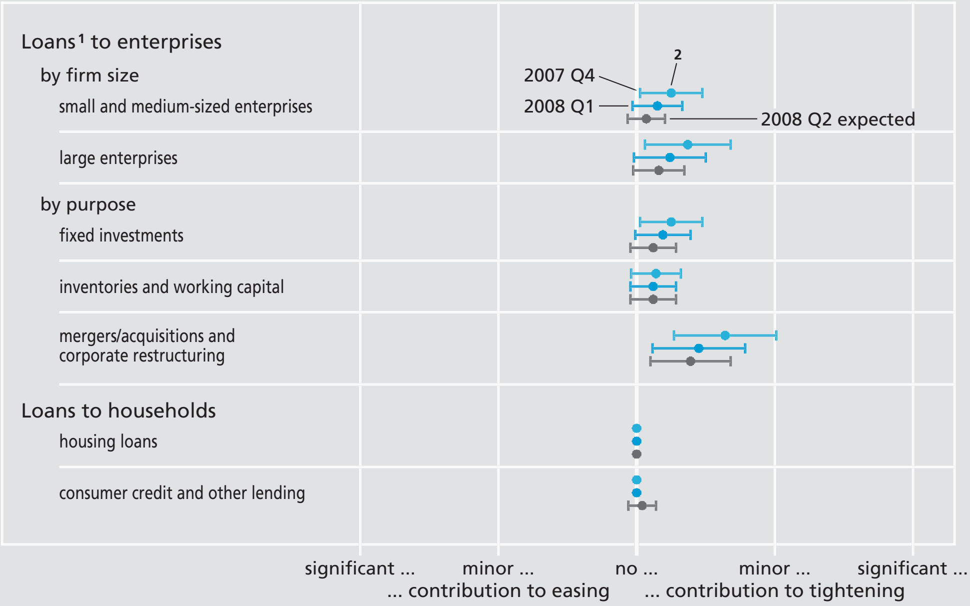
Unlike the producing enterprises, households reduced their financial investment slightly to €115 billion in 2007. Nevertheless, at €86 billion, twice as much flowed into bank deposits than had done in 2006. This very large inflow, which was especially pronounced in the second half of last year, concerned mainly short-term time deposits; given their remuneration at market rates, this form of saving was evidently quite attractive, particularly towards the end of 2007 when money market rates for deposits held beyond the end of the year were picking up markedly. Households reduced their portfolio investment in the form of shares and bonds on a broad front, mainly in the second half of 2007. This development is also likely to have affected the certificates issued by banks. These are often similar to derivatives and, for statistical purposes, are recorded under debt securities. Depending on their characteristics, they have become less attractive as a result of the turbulence in the financial markets. Investment fund shares were purchased on a sizeable scale in net terms in the first six months of last year, at a figure of more than €20 billion. In the second half of the year, however, households invested only €4 billion in them on balance. From the third quarter, it was mainly shares of domestic mutual funds that were sold. This particularly affected money market funds, which, in turn, also invested some resources in paper whose rating has now been downgraded owing to the problems in the financial markets.

Institutional financial investors, too, increased their bank deposits comparatively strongly in 2007. Insurers and pension funds topped up their bank deposits by almost €40 billion, for example. As usual, they showed a preference for longer-term time deposits. Mutual fund shares, which – after bank deposits – are the second-largest item in the portfolio of the insurance sector, were acquired only on a relatively minor scale (€15 billion). Insurers reduced their net equity investments by €8 billion. Other financial institutions, which include mainly the investment funds, also topped up their liquidity buffer in the form of bank deposits by €34 billion in 2007, which was more than usual. While sight deposits were mainly preferred in the first half of the year, there was a switch to short-term time deposits carrying a higher rate of interest towards the end of the year. Financial institutions sold shares on a considerable scale (€41 billion). By contrast, as in 2006, they acquired debt securities and mutual fund shares worth around €30 billion, the majority of which were bought in the first six months of 2007.

Summary

Ultimately, the financial accounts reflect extensive portfolio shifts within the various sectors. Borrowing does not seem to be impaired however. This is shown, in particular, by the sharp rise in bank loans to producing enterprises in the last few months of 2007. To that extent, there were no identifiable retarding effects on the level of procurement of machinery and equipment. This is, not least, a reflection of the sound condition of German enterprises, which have clearly improved their balance sheet structures and possess a large amount of internal financial resources. This applies also, and especially, to small and medium-sized enterprises.[1] Moreover, there are other positive structural factors which have strengthened the resilience of the German economy. For example, the household debt ratio has also shown a marked fall in the past few years, there are no exaggerations in house prices, and a good deal of progress has been made in making the labour market more flexible. All this is likely to have played a part in the economic situation proving to be comparatively robust against the background of the tensions in the money and capital markets.

Effects of financial market turbulence on credit standards*



* Selected results of the quarterly survey on German banks' lending business. Full survey results can be viewed at www.bundesbank.de/volkswirtschaft/vo_veroeffentlichungen.php. — **1** Including credit lines. — **2** ● = mean; |——| = the range shown includes one standard deviation.

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ever, the recent tension on the European money market and interest rate hikes on the capital market may have exerted some upward pressure on interest rates.