Monetary policy and banking business

Interest rate policy and the money market

Main refinancing rate remains at 1%

Given weak macroeconomic growth at the beginning of the year, persistent marked capacity underutilisation and subdued monetary and credit growth, the Governing Council of the ECB decided to leave the Eurosystem's key policy rates on hold between January and May. The interest rate on central bank liquidity as part of main refinancing operations, which were once again conducted as fixed-rate tenders with full allotment in the first quarter of 2010, thus remained at 1%; the interest rate on the marginal lending facility was 1.75%. Deposits held under the deposit facility were remunerated at 0.25%.

Initial phasing-out of individual non-standard measures

In light of the recovery on the financial markets during the first few months of 2010, the Governing Council continued to phase out non-standard monetary policy measures. For example, in conjunction with the Federal Reserve and the Swiss National Bank, it stopped conducting liquidity swap transactions in US dollars and Swiss francs. The Eurosystem then discontinued six-month refinancing operations at the end of March. The last operation of this kind, like the third and last 12-month tender at the end of December 2009, was interest-indexed. From the end of April, regular three-month operations were once again conducted at a variable interest rate, although – in contrast to the usual practice prior to the financial crisis – the main refinancing rate was applied as the minimum bid rate. The aim of this was to prevent interest rate bids from being too low in view of the ample liquidity in the banking sector. With a volume of around €4.8 billion, de-

mand for this three-month operation was subdued, remaining well below the Eurosystem's reference volume of €15 billion.

Main refinancing operations still conducted as fixed-rate tenders

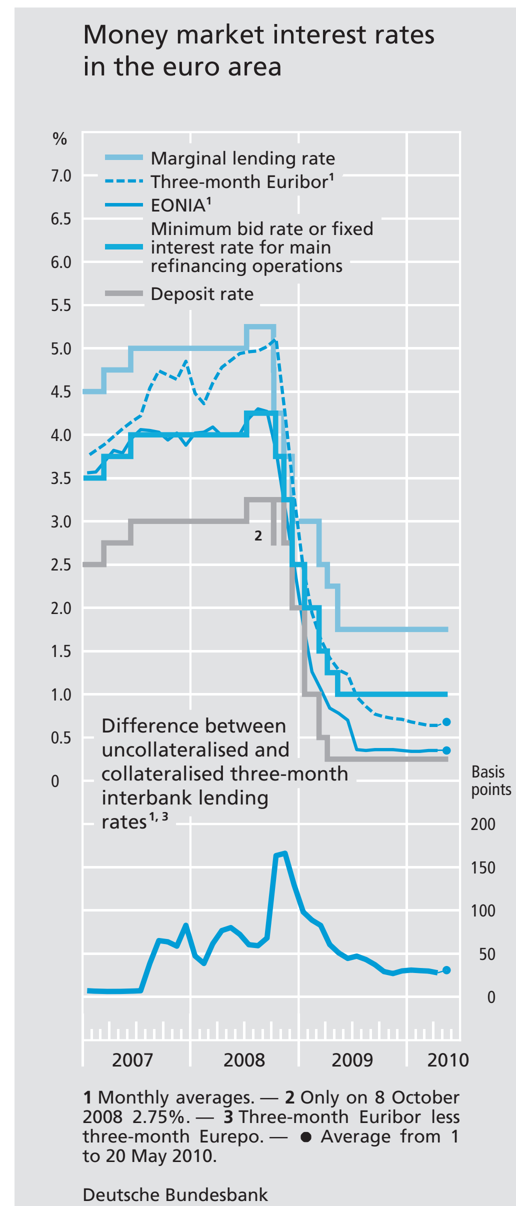
In parallel with the phasing out of the cited non-standard monetary policy measures, however, the Governing Council announced that main refinancing operations and refinancing operations with a maturity of one maintenance period are to be conducted as fixed-rate tenders with full allotment until at least mid-October 2010.

Decisions on collateral framework

In addition, the Governing Council decided in April to introduce, as of 1 January 2011, a schedule of graduated valuation haircuts for marketable and non-marketable assets (excluding asset-backed securities) with a BBB+ to BBB- (or equivalent) rating. Eligible debt securities with a BBB rating can therefore be used as collateral for Eurosystem refinancing operations beyond the end of 2010. Debt securities which are not denominated in euro as well as subordinated debt instruments or securities traded on unregulated markets will, as of January 2011, no longer be accepted as eligible collateral. Furthermore, given what it deemed to be an appropriate Greek consolidation and reform programme, the Governing Council resolved at the beginning of May to suspend the minimum ratings requirements for debt securities issued or guaranteed by the Greek government.

Decisions owing to the exceptional market situation in early May

Owing to the escalating debt crisis in Greece, which gave rise to contagion effects for other euro-area countries, there were severe tensions in some segments of the European financial markets before the second weekend



1 Monthly averages. — 2 Only on 8 October 2008 2.75%. — 3 Three-month Euribor less three-month Eurepo. — ● Average from 1 to 20 May 2010.

Deutsche Bundesbank

in May. On 9 May, the Governing Council therefore decided to reintroduce selected non-standard monetary policy measures and to purchase public and private-sector debt instruments.

In conjunction with other central banks, the Eurosystem is thus once again working with the Federal Reserve to offer liquidity swap transactions in US dollars with maturities of

Money market management and liquidity needs

During the three reserve maintenance periods from 20 January to 13 April 2010, euro-area credit institutions' need for central bank liquidity determined by autonomous liquidity factors fell by €20.9 billion in net terms. The demand for liquidity from banknotes in circulation declined by €3.9 billion during the period under review, owing to the usual seasonal fall in demand for banknotes in the January-February 2010 maintenance period following the sharp rise in the pre-Christmas period. The remaining autonomous factors also contributed to the decline in demand for liquidity in the period under review. First, general government deposits with the Eurosystem went down by a total of €6.2 billion and, second, if the net foreign reserves and the other factors are taken together, a move which eliminates liquidity-neutral valuation effects, there was a decrease in the liquidity needs of €10.8 billion. Factors such as the disbursements of central bank profits, which have an effect on liquidity, including the Bundesbank profit of €4.1 billion paid on 9 March 2010, contributed to this development. In addition to the development of autonomous factors, a decline in the minimum reserve requirement (€1.3 billion net) also contributed to the fall in demand for central bank liquidity.

As was the case in previous months, the Eurosystem continued to provide a generous supply of liquidity during the period under review. All liquidity-providing open market operations were carried out as fixed-rate tenders with full allotment (see table on page 34), thus enabling credit institutions to decide for themselves how much liquidity they required from the Eurosystem and even to exceed the benchmark level. Given the still limited functioning of the money market, this considerably improved the banking system's refinancing opportunities. During the period under review, credit institutions' demand for central bank money in liquidity-providing open market operations increased by around €19 billion in net terms. This rise was largely attributable to main refinancing operations (€17 billion). Moreover, credit institutions received additional liquidity from the Eurosystem's purchase programme for covered bonds, which will be continued until the end of June 2010. During the three reserve periods under review, holdings increased as planned by just over €15 billion to €46.4 billion. The reduced demand for liquidity from autonomous factors in conjunction with the additional provision of liquidity as part of the open market operations as well as the inflow of liquidity from the purchase programme for covered bonds led to a discernible increase in recourse to the deposit facility (+€54 billion in net terms during the period under review). By contrast, the marginal lending facility continued to be used sparingly. The abundant supply of liquidity was also reflected in the EONIA fixings. The reference rate for unsecured overnight money was set at around 0.33% throughout most of the three reserve periods under review. Noticeable increases could only be observed on the last day of each reserve period, when EONIA rose to as much as 0.66% owing to the liquidity-absorbing fine-tuning operations of the Eurosystem. Apart from this exception, the overnight rate continued to be oriented to the interest rate on the Eurosystem deposit facility (0.25%).

After deciding on initial steps to facilitate a move away from its liquidity policy characterised by non-standard measures (including the discontinuation of the supplementary three-month tenders and the 12-month operations) in December 2009, the ECB Governing Council announced further measures in the first quarter of 2010. Liquidity-providing operations in US dollars and Swiss francs were not extended further and were offered to the Eurosystem's counterparties for the last time in January 2010. Furthermore, at the beginning of March, the ECB Governing Council decided to switch from fixed-rate tenders to variable-rate tenders with target allotment volumes (and a minimum bid rate) for three-month tenders from April 2010 onwards. At the same time, the Council announced that both the main refinancing operations and the special tender with a maturity of one reserve maintenance period will continue to be carried out as fixed-rate tenders with full allotment until at least the beginning of October 2010. Furthermore, according to a Council decision, on 1 July 2010, a fine-tuning operation with a maturity of six days should help to (partly) offset the liquidity outflow of €442 billion resulting from the first 12-month tender which matures on this day.

In the January-February 2010 reserve maintenance period, which only lasted three weeks, the average outstanding refinancing volume amounted to around €710 billion and was thus considerably higher than credit institutions in the Eurosystem would need calculated on the basis of the liquidity needs arising from autonomous factors and the reserve requirement. As a result, the excess liquidity (on the basis of the benchmark amount) amounted to €230 billion on

Deutsche Bundesbank

average, which was also reflected in the high average degree of recourse to the deposit facility (€168 billion). EONIA turnover averaged €27.0 billion per day and was thus again somewhat below the already quite low average trading volume of €29.1 billion in the previous period.

In the February-March reserve period, the demand for liquidity in the main refinancing operations increased perceptibly. The average allotment volume in the main refinancing operations, which had remained at around €60 billion in the previous period, rose significantly to €80 billion in the period under review. At the same time, the outstanding refinancing volume in the longer-term refinancing operations fell by a similar degree, supported by the phasing-out of supplementary long-term tenders, the due volumes of which could no longer be extended by credit institutions as a result of the start of the move away from non-standard measures. There continued to be a high level of recourse to the deposit facility (€186 billion on average), which was a consequence of liquidity conditions remaining very comfortable (excess liquidity of €258 billion on average).

The main focus of the March-April reserve period was the allotment of the six-month tender. At the time, no further operation with this maturity was planned. As in the case of the last 12-month tender in December 2009, this fixed-rate tender was allocated at an interest rate corresponding to the average minimum bid rate of the main refinancing operations carried out during the life of this operation. In the run-up to the tender, there was uncertainty among the market participants regarding the total demand volume for the six-month tender. This was reflected, *inter alia*, in a wide range of forecasts (€20 billion to €150 billion). However, the actual bidding and allotment volume of €17.9 billion was below even the lowest expectations and made it clear that credit institutions now had hardly any interest in additional central bank liquidity. The further increase in excess liquidity in this reserve period (€283 billion on average) and the associated high level of recourse to the deposit facility (€201 billion on average), provide further evidence of this liquidity saturation. Trade in the (short-term) money market continued to be impaired by the existing liquidity surpluses. (Unsecured) EONIA turnover averaged only €27.2 billion per day (previous period: €27.0 billion) and turnover from secured overnight money on Eurex Repo's Euro GC Pooling also amounted to just €5.6 billion (previous periods: €6.2 billion and €5.4 billion). In comparison, this segment had recorded an average daily trading volume of €9.0 billion in 2009.

At the end of the subsequent April-May reserve period, the ECB Governing Council passed several measures to address the marked increase in tension in the financial markets. In this context, the Eurosystem announced that it would intervene in the euro area public and private debt securities markets, offer the regular three-month tenders as fixed-rate tenders with full allotment again in May and June 2010, carry out a further six-month tender with full allotment and resume US dollar liquidity-providing operations.

Factors determining bank liquidity [1]

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

Item	2010		
	20 Jan to 9 Feb	10 Feb to 9 Mar	10 Mar to 13 Apr
I Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors			
1 Banknotes in circulation (increase: –)	+ 13.2	– 1.0	– 8.3
2 General government deposits with the Eurosystem (increase: –)	– 2.8	+ 9.4	– 0.4
3 Net foreign reserves [2]	+ 12.6	+ 1.3	+ 12.9
4 Other factors [2]	– 14.6	+ 1.8	– 3.2
Total	+ 8.4	+ 11.5	+ 1.0
II Monetary policy operations of the Eurosystem			
1 Open market operations			
(a) Main refinancing operations	– 0.9	+ 20.8	– 2.8
(b) Longer-term refinancing operations	+ 13.8	– 21.1	+ 9.4
(c) Other operations	– 0.1	+ 7.3	+ 7.7
2 Standing facilities			
(a) Marginal lending facility	– 0.2	+ 0.7	– 0.5
(b) Deposit facility (increase: –)	– 21.3	– 18.1	– 14.3
Total	– 8.7	– 10.4	– 0.5
III Change in credit institutions' current accounts (I + II)	– 0.3	+ 0.9	+ 0.7
IV Change in the minimum reserve requirement (increase: –)	– 0.6	+ 1.4	+ 0.5

1 For longer-term trends and the Deutsche Bundesbank's contribution, see pages 14* and 15* of the Statistical Section of this Monthly Report. — **2** Including end-of-quarter valuation adjustments with no impact on liquidity.

Open market operations of the Eurosystem*

Value date	Type of transaction 1	Maturity in days	Actual allotment in € billion	Deviation from the benchmark 2 in € billion	Marginal rate/fixed rate %	Allotment ratio %	Weighted rate %	Cover ratio 3	Number of bidders
20.01.10	MRO (FRT)	7	58.0	172.0	1.00	100.00	–	1.00	101
20.01.10	S-LTRO (FRT)	21	5.7	–	1.00	100.00	–	1.00	7
27.01.10	MRO (FRT)	7	63.4	245.9	1.00	100.00	–	1.00	83
28.01.10	LTRO (FRT)	91	3.3	–	1.00	100.00	–	1.00	22
03.02.10	MRO (FRT)	7	55.8	264.8	1.00	100.00	–	1.00	74
09.02.10	FTO (–)	1	– 270.6	–	0.80	100.00	0.76	1.00	187
10.02.10	S-LTRO (FRT)	28	2.8	–	1.00	100.00	–	1.00	14
10.02.10	MRO (FRT)	7	76.1	186.6	1.00	100.00	–	1.00	79
17.02.10	MRO (FRT)	7	81.9	260.9	1.00	100.00	–	1.00	78
24.02.10	MRO (FRT)	7	81.4	277.9	1.00	100.00	–	1.00	71
25.02.10	LTRO (FRT)	91	10.2	–	1.00	100.00	–	1.00	23
03.03.10	MRO (FRT)	7	80.5	297.0	1.00	100.00	–	1.00	65
09.03.10	FTO (–)	1	– 294.5	–	0.80	100.00	0.76	1.00	193
10.03.10	MRO (FRT)	7	78.4	206.4	1.00	100.00	–	1.00	71
10.03.10	S-LTRO (FRT)	35	9.3	–	1.00	100.00	–	1.00	11
17.03.10	MRO (FRT)	7	79.0	297.0	1.00	100.00	–	1.00	79
24.03.10	MRO (FRT)	7	81.1	312.1	1.00	100.00	–	1.00	81
31.03.10	MRO (FRT)	7	78.3	295.3	1.00	100.00	–	1.00	73
01.04.10	S-LTRO (FRT)	182	17.9	–	4 ...	100.00	–	1.00	62
01.04.10	LTRO (FRT)	91	2.0	–	1.00	100.00	–	1.00	11
07.04.10	MRO (FRT)	7	71.5	281.5	1.00	100.00	–	1.00	67
13.04.10	FTO (–)	1	– 292.3	–	0.80	100.00	0.76	1.00	186

* For more information on the Eurosystem's operations from 14 October 2009 to 19 January 2010, see Deutsche Bundesbank, Monthly Report, February 2010, p 27. — **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), FRT: fixed-rate tender. — **2** Excluding (S-)LTROs allotted in the same week. — **3** Ratio of total bids to the allotment amount. — **4** The interest rate is the average minimum bid rate of the MROs over the life of this operation.

Deutsche Bundesbank

seven and 84 days, which are being conducted as fixed-rate tenders with full allotment. Moreover, a further interest-indexed six-month refinancing operation was conducted in mid-May, and the regular three-month refinancing operations scheduled for the end of May and the end of June are to be conducted once again as fixed-rate tenders with full allotment.

The Governing Council also resolved to counteract the severe tensions in the financial markets through targeted purchases of public and private-sector debt securities in the euro area. This decision should be seen in close connection with the announcement of additional consolidation measures in the relevant euro-area countries to safeguard the sustainability of public finances. In order to ensure that the measures adopted by the Governing

Council have no additional impact on the monetary policy stance, the liquidity generated by the purchase programme is to be reabsorbed by targeted absorption operations.

EONIA still just above interest rate on deposit facility

The euro money market's response in the year to date has been reserved overall, both with regard to the initial phasing-out of individual non-standard monetary policy measures and to the severe tensions in the financial markets at the beginning of May. As in the second half of 2009, the overnight interest rate (EONIA) continued to be around 0.1 percentage point above the interest rate on the Eurosystem's deposit facility between January and May, fluctuating only marginally. The persistently low overnight rate is due, furthermore, to generous lending by the Eurosystem.

Longer-term money market rates showing slight upwards trend at end of 2010 Q1

There was a sideways trend in longer-term money market rates, too, from January to April. Tendencies to a slight upward movement have been noticeable since the end of April, although these weakened following the announcement of the non-standard measures of the second weekend in May. Since the beginning of the year, uncollateralised interbank rates with maturities of up to and including six months have been consistently quoted below the Eurosystem's main refinancing rate. The uncollateralised three-month rate (3M Euribor) currently stands at 0.70% and its collateralised counterpart (3M Eurepo) at 0.35%. The risk premium on the euro money market, which is determined on the basis of their yield spread, is currently 0.35 percentage point and has thus increased slightly since the beginning of May.

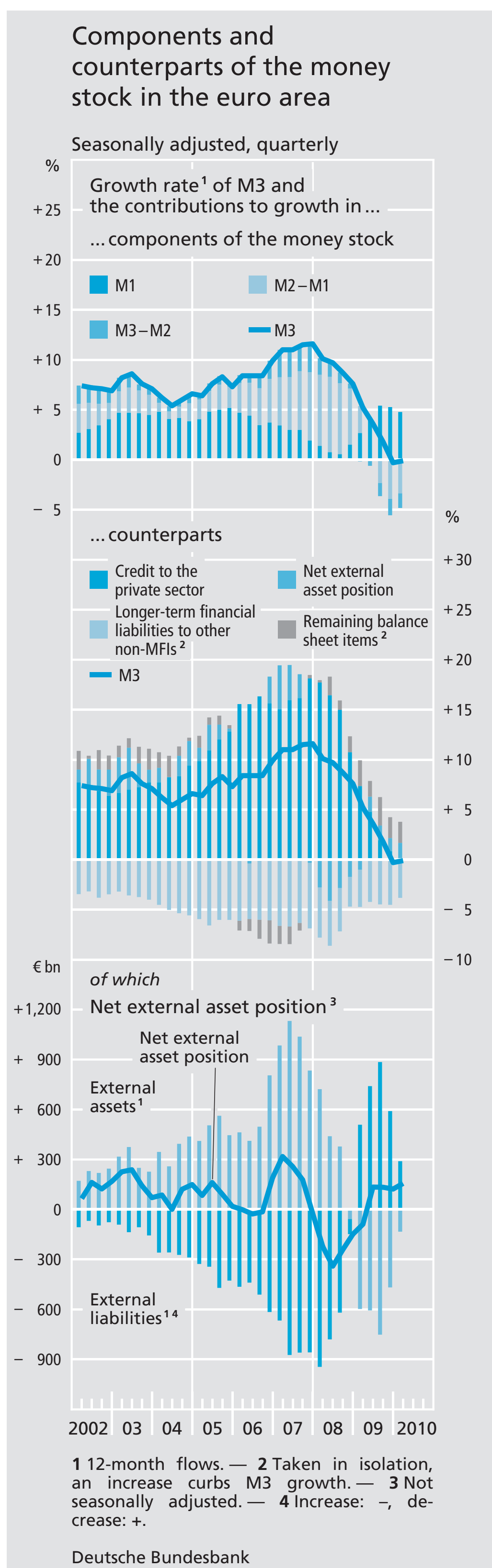
Monetary developments in the euro area

No further weakening of monetary expansion

There was no further weakening of monetary expansion in the euro area between January and March 2010. In seasonally adjusted and annualised terms, the three-month rate of the broad monetary aggregate M3 amounted to -½% in the reporting quarter. While still negative, this was nonetheless an improvement on the corresponding rate of -1½% in the final quarter of 2009, which was the lowest quarterly value since the launch of monetary union. Owing to base effects, the average of the annual M3 growth rates for the first quarter of 2010 remained at its prior-quarter level of -0.1%.

Demand for highly liquid M3 components weaker, but still buoyant

The interest rate environment, characterised by assets with a maturity of up to two years having a comparatively small interest rate advantage over overnight deposits and by a steep yield curve for maturities of over two years, has had a major impact on monetary growth since the fourth quarter of 2008. This constellation led to shifts from short-term time deposits (with an agreed maturity of up to two years) remunerated at close-to-market rates into the most liquid components of M3, although these were less pronounced in the last quarter of 2009 and the first quarter of 2010. At a seasonally adjusted and annualised three-month rate of 6% in the first quarter of 2010, the rise in overnight deposits was marked, but remained below the rate (9%) of the previous quarter. By contrast, there was an accelerated annualised increase in quantitatively less significant cash in circulation in the first quarter, from just under 5% in the previous three-month period to more



1 12-month flows. — 2 Taken in isolation, an increase curbs M3 growth. — 3 Not seasonally adjusted. — 4 Increase: –, decrease: +.

Deutsche Bundesbank

than 11%. As a result, expansion of the narrow monetary aggregate M1 slowed overall. It was still strong, however, growing by a seasonally adjusted and annualised three-month rate of 7%, compared with over 15% and almost 8½% in the third and fourth quarters of 2009 respectively.

Another net reduction in short-term deposits other than overnight deposits ...

At the same time, there was a slower reduction in short-term deposits other than overnight deposits; at a seasonally adjusted and annualised three-month rate of -5%, the decline was more muted than in the preceding four quarters. This was due mainly to the significant reduction in the release of short-term time deposits, even though holdings of such deposits still fell perceptibly at a seasonally adjusted and annualised rate of 15%, compared with -26% in the previous quarter. This development was driven chiefly by households. On the back of substantial shifts in recent years, households released a smaller amount of time deposits in the reporting quarter due to the currently rising interest rates for time deposits with a maturity of up to one year. Short-term savings deposits (with an agreed period of notice of up to three months) continued to be in demand, but to a lesser extent than in the preceding quarters.

... and in marketable instruments

At a seasonally adjusted and annualised three-month rate of -14%, there was little aggregate change in the development of marketable financial instruments compared with the preceding quarters. Between January and March, this was due to strong net outflows from money market funds, which account for the largest share of marketable instruments. Transfers from liquid money to

longer-term types of investment probably played a major part in this. By contrast, repo transactions, which are usually very volatile, virtually stagnated on balance in the reporting quarter. Furthermore, for the first time in six quarters, slightly positive net inflows of short-term debt securities of monetary financial institutions held by non-banks (with a maturity of up to two years) were recorded.

Lending to the private sector again slightly negative

In the reporting quarter, weak monetary growth was again accompanied by slightly negative net lending to the private sector; the seasonally adjusted and annualised three-month rate fell from -½% in the final quarter of 2009 to -1% at the end of the reporting period. In the first quarter of 2010, this development was accompanied by a net reduction in securities held by euro-area banks and issued by domestic private non-banks as well as by stagnating lending in the form of loans. At 0%, its annualised and seasonally adjusted three-month rate almost matched the annualised three-month rate of lending to the domestic private sector adjusted for credit institutions' securitisation activities and loan sales. This was due to the current low level of securitisation activity in the banking sector.

Continuing upwards movement in loans to households

In the reporting period, stagnation in loans to domestic private non-banks was again the outcome of heterogeneous sectoral developments. Loans to households rose significantly in net terms, with the positive development of the previous three quarters becoming increasingly firmer. This was again attributable to growth in loans for house purchase, which make up the lion's share of household borrowing, and to which government assistance programmes also contributed. However, other lending to households also rose perceptibly, while consumer credit declined markedly in the reporting quarter following slight growth in the two preceding quarters.

Virtual stagnation of loans to non-financial corporations

Following three quarters of strong decline in loans to non-financial corporations, their seasonally adjusted volume remained virtually unchanged in the first quarter, chiefly as a result of noticeably positive net lending in February. For the first time since the final quarter of 2008, medium-term loans (with maturities of more than one year and up to five years) fell significantly more sharply in the reporting quarter than short-term loans. By contrast, there was a further marked expansion in long-term loans. Overall, this is consistent with the pattern that is familiar from earlier periods of economic recovery, with unsecuritised lending to non-financial corporations recovering more slowly from the slump in economic activity than lending to households.

Marked decline in loans granted to other financial intermediaries

In the reporting quarter, loans to the private sector in the euro area were dampened for the most part by loans to other financial intermediaries. Overall, these fell significantly in the first quarter, while they had a slightly positive influence on growth in loans to the private sector in the fourth quarter of 2009. Many of these transactions are highly volatile indirect interbank operations; therefore, restricted lending to this sector does not, in itself, represent a classical withdrawal of funds for the private non-banking sector.

Slight drop in securities acquisitions by banks

Funds made available to the private sector in the euro area as a result of securities acquisitions by domestic banks fell at an annualised and seasonally adjusted three-month rate of 6½% in the first quarter following a decline of more than 2½% in the preceding three-month period. This accelerated decrease was due largely to special national factors. In the first quarter of 2010, a decline in securities issued by the private sector was again accompanied by a recognisable increase in banks' holdings of securities issued by the public sector (loans issued by banks to the public sector were at a comparable level in the reporting quarter); the corresponding seasonally adjusted and annualised three-month rate went up from just over 2½% in the previous quarter to almost 8½% at the end of the reporting period.

Slight increase in net external assets

In the first quarter of 2010, the net external assets of the euro-area MFI sector rose by €11.6 billion on the quarter in seasonally adjusted terms and, thus, taken in isolation, had an expansionary effect on monetary growth. This means that there was a significant drop in funds provided through foreign payment transactions by non-banks in the euro area compared with each of the previous three quarters.

Moderate monetary capital formation

As in the previous quarter, monetary capital formation was relatively moderate. MFI longer-term financial liabilities rose by 3½% in seasonally adjusted and annualised terms in the first quarter of 2010, compared with just over 3% in the previous quarter. This has tended to slow the pace of monetary growth. The increase affected all components; in particular, euro-area credit institutions raised funds from non-banks in the form of bank debt securities with longer maturities. Banks also topped up their capital and reserves in the reporting period, albeit to a somewhat smaller extent than in the preceding quarters. Furthermore, long-term time deposits remained attractive – especially for households – given the continued steep yield curve. As in the fourth quarter of 2009, however, the resulting inflows were largely masked by special-purpose vehicles reducing their holdings of time deposits in connection with the scaling-back of banks' securitisation activities. Domestic non-banks increased their holdings of long-term savings deposits only slightly in the reporting quarter.

No pronounced risk to price stability from a monetary perspective

Overall, there was no further weakening of the underlying monetary dynamics – in other words, monetary growth which is ultimately relevant to inflation – in the reporting quarter. M3 once again declined slightly between January and March, not least owing to the particular interest rate environment. At the same time, loans to the private sector in the euro area stagnated. Inflation projections based on monetary data, taken as a whole, also continue to indicate that there will be no pronounced risk to price stability in the euro area in the next three years. Nevertheless, as in the preceding quarters, the dispersion of these projections is relatively high. This underlines the fact that there is currently still a high degree of uncertainty associated with such an outlook.

German banks' deposit and lending business with domestic customers

Rise in domestic investors' balances at German banks, ...

After two quarters of decline, domestic investors again started to increase their deposits held by German banks in the first quarter of 2010. The seasonally adjusted and annualised three-month rate rose from just over -1% in the fourth quarter of 2009 to almost 2½% in the period from January to March. It is not yet clear, however, whether this means that the negative growth in deposits observed in the second half of 2009 has finally come to an end.

... at slower pace in almost all deposit types

Overall, there was a clear quarter-on-quarter decline in the growth of almost all deposit types in the first three months of 2010. Short-term time deposits shrank at a seasonally adjusted and annualised three-month rate of -13% in the reporting quarter, which was a considerably slower rate than in the fourth quarter of 2009 (-45%). Overnight deposits grew at a corresponding rate of only slightly more than 6½% in the first quarter on the back of just under 14½% in the preceding quarter. The behaviour of households and financial corporations was largely responsible for the development of both types of deposit. Only the increase in short-term savings deposits (mainly by households) was almost as strong as in the preceding quarter, growing at a seasonally adjusted and annualised three-month rate of just under 10%, compared with just over 11% in the final quarter of 2009.

While there was a net quarter-on-quarter increase in demand for short-term deposits in the first three months of 2010, there was a net decrease in long-term deposit types following net growth in the previous quarters. This chiefly affected long-term savings deposits (with an agreed period of notice of over three months), which shrank by 4½% in seasonally adjusted and annualised terms in the reporting quarter. While there was a slight increase in the quantitatively more significant long-term time deposits (with an agreed maturity of over two years) during the same period, the corresponding three-month rate had fallen further to ½% by the end of the reporting period. This waning momentum reflects, first, the slower but still sharp reduction in these balances by insurance companies and pension fund reserves and, second, the fact that households' strong demand for long-term time deposits since the

Long-term deposit types attracting less attention

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

€ billion

Item	2010 Jan to Mar	2009 Jan to Mar
Deposits of domestic non-MFIs 1		
Overnight	11.4	69.3
With agreed maturities		
of up to 2 years	– 30.5	– 83.3
of over 2 years	2.8	12.1
Redeemable at notice		
of up to 3 months	12.4	11.8
of over 3 months	– 2.2	0.8
Lending		
to domestic enterprises and households		
Loans	– 23.5	4.9
Securities	– 6.4	7.5
to domestic general government		
Loans	0.3	– 4.7
Securities	13.8	5.5

* 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 general government excluding central government.

Deutsche Bundesbank

The impact of the financial and economic crisis on the 2009 financial accounts

The global financial and economic crisis has caused severe turmoil in the financial sector and has hit the real economy hard. This article will examine recent financial accounts data to determine how far these developments are reflected in the financial transactions and asset holdings of the domestic sectors.[1]

Sharp decline in corporate financial flows

According to the available financial accounts data, the financial flows of the non-financial sectors as a whole, ie households, producing enterprises and general government, fell appreciably in 2009. This is fairly typical of economic downturns. In 2009, the acquisition of financial assets in these sectors dropped by almost €100 billion to €225 billion, and demand for funds was €40 billion lower at €117 billion.

A sectoral breakdown shows that this negative development in financial flows was driven mainly by non-financial corporations. They reduced their financial transactions by a total of some €200 billion, or just short of 90%, compared with 2008. Their external financing needs were even slightly negative in 2009 (-€0.3 billion), ie they reduced their liabilities slightly in net terms. One year previously, inflows of external finance had stood at more than €100 billion. Although this contrasted with positive financial investment on the asset side, at around €37 billion it was significantly lower than in 2008, when a figure of €132 billion was recorded. This curtailment of financial activities, which set in as early as the beginning of 2009, was also in evidence in the first half of the last decade as enterprises attempted to consolidate their balance sheets after the end of the stock market boom. Up until the onset of the financial and economic crisis, non-financial corporations – and, in particular, small and medium-sized enterprises – bolstered their capital base significantly, thereby further improving their resilience. By contrast, the reduction in financial flows seen in 2009 was not the result of enterprises' attempts to clean up their balance sheets, but rather a reflection of the severe economic downturn.

The main reason for the poor development in liabilities in 2009 was the reduction of loans from domestic and foreign banks by some €50 billion net. In each of the previous two years, loan demand had been at this level. By contrast, financing through foreign loans to group affiliates, an instrument used mainly by relatively large and internationally active enterprises, was positive, albeit, at €17 billion, lower than in 2008. Developments in external funding via the capital markets were also mixed. For the first time since 2007, equity financing was fairly abundant again in the reporting year, as stock market prices had risen, and stood at €5½ billion net. Moreover, significantly more funds were raised by issuing longer-term bonds than in 2008, namely just under €20 billion. At the same time, however, almost €27 billion worth of short-dated money market paper were redeemed in net terms. As a result of the weak overall demand for external financing in the form of bank loans and debt securities, the financial debt of producing enterprises had fallen to just under €1,590 billion by the end of 2009 and was consequently 1½% down on the year. Nonetheless, their debt ratio rose appreciably, from 112% to 119% of gross value added. This was because the economic slump caused enterprises' output to fall sharply.

According to the national accounts data published by the Federal Statistical Office, there was a sharp decline not only in external financing requirements but also in financing using profits and depreciation. Both items added up to €234 billion in the reporting year, some €50 billion less than in 2008. Almost nine-tenths of internal funds were attributable to depreciation on tangible fixed assets, which fell only slightly in 2009. Although producing enterprises generated retained earnings despite the difficult economic environment, these, at €12 billion, were significantly lower than in 2008, when they had been almost five times as high. As enterprises simultaneously slashed spending on real investment from almost €280 billion in 2008 to €213 billion at the end of the period under review, they were able to fund more than 90% of their financial and real investment internally. This ratio is extremely high in a longer-term comparison. In nominal terms, aggregate retained earnings and depreciation were therefore sufficient to finance all investment in the capital stock internally. This means that enterprises as a whole were net acquirers of financial assets in the economically difficult year of 2009, and were therefore, on balance, not reliant on funds from other sectors. This may be seen as an indication that there was no broad-based credit crunch last year.

Considerable increase in public debt

In contrast to enterprises, general government's financial activities were at an extremely high level in 2009, especially their external financing requirements. The latter amounted to €120 billion net and was, for the most part, covered by securities issuance. General government's debt financing was therefore appreciably higher than at any time since reunification – with the exception of 1995, when it had stood at al-

1 For the most recent financial accounts figures, see Table VIII in the statistical section at the back of this Monthly Report.

Deutsche Bundesbank

most €170 billion owing to the integration of the Treuhand agency into the government sector. Overall, public debt totalled around €1,830 billion at the end of 2009 (calculated at current prices in line with the financial accounts). On the asset side, government (as in 2008) expanded its financial assets substantially by just over €40 billion to a total of €670 billion – principally as a result of support measures for credit institutions. Accordingly, the government's fiscal deficit, at almost €80 billion, was significantly lower than its external financing requirements. However, a comparison with 2007 and 2008, when government posted slight surpluses, shows how severely public finances have deteriorated in the wake of the financial and economic crisis.

Improvement in households' financial assets

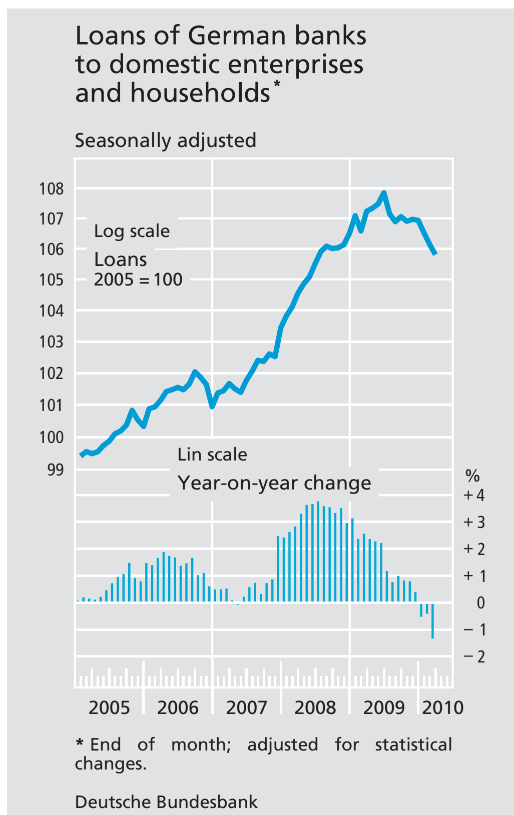
Households acquired substantially more financial assets, at €147 billion, than one year earlier (€126 billion). These intensified saving efforts – the savings rate rose to 11.3% of disposable income – were accompanied by a correction of the considerable portfolio shifts, most of which had been undertaken at the height of the financial crisis. For instance, net inflows to bank deposits (including cash), at €50 billion, were significantly more moderate than in 2008, when a record figure of more than €120 billion was reached. This can be attributed to a normalisation in cash holdings, which rose by €7½ billion in the full year 2009, having been boosted by €17 billion in the final quarter of 2008 alone. Moreover, households substantially reduced their time deposits by €124 billion, which they had expanded considerably in 2008, by €77 billion – not least because of relatively favourable conditions. The main beneficiaries of this were sight and savings deposits, which attracted net funds of €141½ billion and €56 billion respectively in 2009. The main reasons for this pronounced restructuring were probably the very low interest rates available on time deposits and the greater liquidity of sight and savings deposits.

Households' investment behaviour in terms of securities has also returned to normal again. Compared to 2008, when households sold mainly stocks across the board in response to the financial crisis, there was only a marginal decline in this segment in 2009. By contrast, households acquired a considerable volume of mutual fund shares (+€29 billion). Given a rise in share prices, domestic equity-based funds open to the general public also recorded significant net inflows of €6 billion – which was previously not the case. Furthermore, households acquired other equity directly, though only on a small scale (+€3 billion). By contrast, debt securities were reduced by €4½ billion net. In 2009, inflows to the entitlements on insurance corporations, which mainly comprise regular premiums payments but may also include one-off payments, were roughly twice as high as one year earlier at more than €63 billion. They were thus back at their 2006 and 2007 level.

Overall, households' financial assets had risen appreciably by end-2009 to around €4,670 billion, or €116,000 per household. Financial assets were thus €240 billion or, per household, more than €5,000 higher than one year earlier when investment had dropped sharply as a result of the financial crisis. Besides their own savings efforts, this can also be attributed to large average gains in share and securities prices. The latter totalled roughly €90 billion. Households' debt to banks and insurance corporations remained virtually unchanged in the reporting year, however, amounting to €1,530 billion, or an average of €38,000 per household, at the end of last year. On balance, the net asset position of households improved considerably in 2009. At 293% of disposable income, net financial assets were almost back at their 2007 record high of 296%.

Summary

Overall, the financial accounts for 2009 bear testimony to large-scale adjustments in the individual domestic sectors in response to the financial and economic crisis. These relate to both investment volume and investment structure. The latter is particularly pronounced for households, which last year reversed the considerable portfolio restructuring of end-2008. In addition, they substantially improved their overall asset position. By contrast, the financial activities of general government and producing enterprises were characterised by considerable turmoil in 2009. While the latter massively curtailed their financial transactions in the wake of the economic slump, lower tax revenues and higher spending to support the economy and the financial sector meant that the public sector was forced to sharply expand borrowing. Based on recent positive economic data and the latest forecasts, corporate financial flows are also likely to rise in future. Public finances, which are currently subject to various strains, are undoubtedly in a more difficult situation. Despite all the problems, there is no alternative to a credible return to sustainable public finances – while maintaining stable prices. This is the only way to create confidence on a broad front and eliminate uncertainty in the financial markets.



* End of month; adjusted for statistical changes.

Deutsche Bundesbank

final quarter of 2009 was easing off during the reporting period.

Declining credit provision by German banks

Overall credit provision by domestic credit institutions to the domestic private sector contracted sharply in seasonally adjusted terms in the reporting quarter, falling well into negative territory. The seasonally adjusted and annualised three-month rate for total credit fell from 0% in the fourth quarter of 2009 to -5½% in the reporting quarter. This development was caused primarily by the dynamics of credit to financial corporations. It should be borne in mind, however, that the seasonal adjustment of current data is subject to increased uncertainty insofar as the financial crisis has led to a change from earlier usual seasonal behaviour.

Massive reduction in private-sector securities holdings

In the first quarter, there was a strong seasonally adjusted net decrease in securitised lending to the private sector. In annualised terms, it shrank by 14½% in the first quarter, compared with a rise of 2½% in the preceding three-month period.

Continuing decline in loans to the private sector

Overall, there was a significant decline in loans to the domestic private sector in the first quarter of 2010. In seasonally adjusted terms, they shrank considerably more sharply than in the two preceding quarters. The annualised and seasonally adjusted three-month rate went down from -½% to just over -4%. The reduction in loans to private borrowers again chiefly affected the short-term segment with maturities of up to one year, especially loans to financial corporations.

Only slight drop in unsecuritised lending to non-financial corporations

Following a decline in lending to the private sector in the fourth quarter of 2009 that was due solely to perceptible net redemptions of loans granted by German banks to domestic non-financial corporations, lending to this sector clearly bounced back at the beginning of the year. In March, however, there was another marked net reduction in loans, signalling that it is not yet possible to assume that there has been a definite turning point with regard to the development of loans to non-financial corporations. The corresponding seasonally adjusted and annualised three-month rate went up from just over -6½% in the final quarter of 2009 to -½% in the reporting quarter. This slower decline is due to the reduction in short-term loans that took place over the preceding four quarters losing momentum in the reporting period and a continuing slight expansion of long-term

loans. Only medium-term loans contracted to a somewhat greater extent than in the preceding quarters. Overall, developments in loans to non-financial corporations in the first quarter of 2010 can still be explained well in terms of developments in the real economy. These figures therefore continue to provide no indication of a credit crunch in Germany.

Slight increase in loans to households

Total loans to households increased slightly in seasonally adjusted terms between January and March. As in the previous quarter, their seasonally adjusted and annualised three-month rate amounted to ½%. In contrast to the fourth quarter of 2009, loans for house purchase virtually stagnated in seasonally adjusted terms; growth was therefore largely attributable to other credit.

Dynamic growth of credit to general government

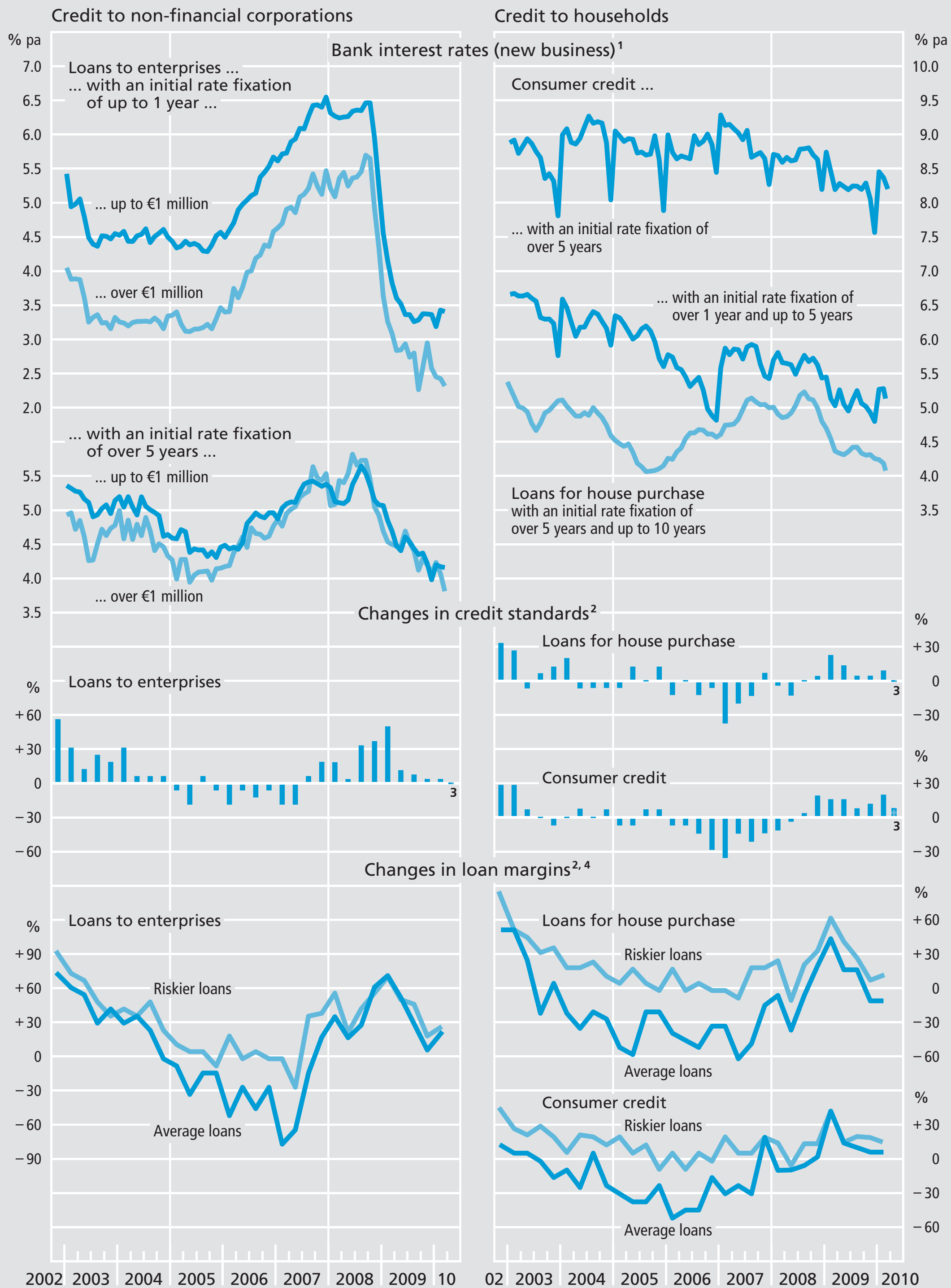
Unlike lending to the private sector, lending to general government expanded strongly between January and March 2010. In seasonally adjusted and annualised terms, it increased by just over 7½%. Specifically, loans increased at a seasonally adjusted and annualised three-month rate of 3% in the first quarter following an obvious decline in the fourth quarter of 2009. At the same time, securitised lending increased by almost 17½%.

Little change in credit standards

The Bank Lending Survey (BLS) for the first quarter of 2010, which was conducted in April 2010, confirms the impression gained in the previous two quarters that the tightening of credit standards in the preceding period was no being longer continued on a broad front. It was only in isolated cases that the surveyed banks tightened their credit standards for loans to enterprises, although, overall, the tighter standards – again, resulting from sector-specific and firm-specific factors – were counteracted by the improved liquidity position of the institutions. By contrast, according to the surveyed institutions, margins were generally more restrictive than in the preceding quarter. Specifically, the tightening of standards was reflected in a considerable expansion of margins on both average-risk and riskier loans. While developments in credit standards in Germany were broadly consistent with those in the rest of the euro area, margins in the EMU sample were adjusted more moderately, albeit still with restrictions.

The surveyed banks had been noting a declining demand for credit from enterprises in the euro area as a whole for some time, German banks, too, now reported a slight drop in net demand for bank loans for the first time since 2008. This development was driven predominantly by declining borrowing requirements for fixed investment as well as improved access to corporate financing on the capital market. Overall, households were faced with somewhat tighter lending conditions by the German banks participating in the BLS. These conditions were shaped, above all, by noticeably tighter standards for consumer credit and somewhat tighter standards for loans for house purchase. Margins – with the exception of average-risk loans for house purchase – were also tightened. At the same time, institutions reported a sharp net decline in households' funding requirements. Mainly fiercer competition in this credit segment was said to be responsible for this development.

Banking conditions in Germany



1 According to harmonised MFI interest rate statistics. — **2** According to the Bank Lending Survey, difference between the numbers of respondents reporting “tightened considerably” and “tightened somewhat” and the numbers of respondents reporting “eased somewhat” and “eased considerably” as a percentage of the responses given. — **3** Expectations for 2010 Q2. — **4** Reduced scale.

Deutsche Bundesbank

The survey round for the first quarter of 2010 again contained additional questions on the impact of the financial crisis on the wholesale funding, capital costs and lending behaviour of the participating banks. According to the surveyed banks, there was a marked improvement in access to wholesale funding on the money and capital markets compared with the previous quarter. Moreover, almost half of the surveyed institutions reported higher capital costs in the wake of the financial crisis, which also caused some banks to place certain restrictions on their lending.

Bank lending rates mostly declining

Despite the considerable expansion of margins reported in the BLS, the interest rate statistics suggest that German institutions passed on part of the more favourable conditions in the capital market to domestic private customers in the first quarter of 2010, too. In the period under review, the reporting institutions were charging interest of 3.4% for small short-term loans to enterprises and 2.3% for large short-term loans to enterprises. For long-term loans, they charged 4.2% and 3.8%, respectively. With regard to loans to households, consumer loans were more expensive than in the previous quarter, while the interest rates on loans for house purchase fell across the board. The long-term interest rate on loans for house purchase stood at 4.3% at the end of March.