Monetary policy and banking business

Interest rate policy and the money market

Main refinancing rate constant at 1%

The macroeconomic setting in the third quarter of 2009 was characterised by low rates of inflation and an incipient economic recovery. Given considerable capacity underutilisation and declining employment, the outlook for prices remained benign. The September ECB staff projections see consumer price inflation rising again slightly for the next two years, albeit at a low level well within the range of stability. Longer-term inflation expectations – according to available survey data – also remain anchored within the ECB Governing Council's definition of price stability of below but close to 2%. In the reporting quarter, monetary growth in the euro area also continued to show a marked decline, mainly because of persistently weak lending. Against this backdrop, the Governing Council maintained its expansionary monetary policy and left its key interest rates on hold in the period from June to September. The Eurosystem therefore continued to provide its counterparties with liquidity at a fixed interest rate of 1% through its main refinancing operations and longer-term refinancing operations. It charged interest of 1.75% on its marginal lending facility and continued to remunerate credit balances at a rate of 0.25% under its deposit facility.

Reduced volume for second 12-month tender

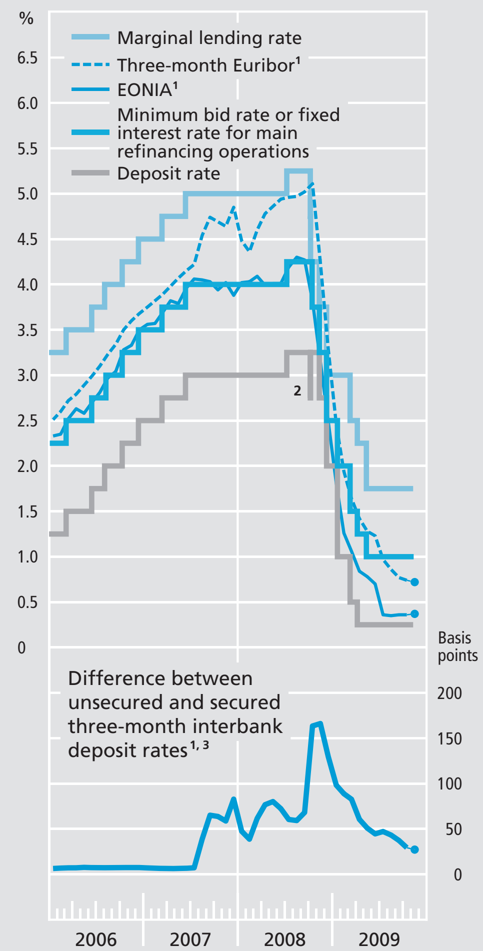
At €75.2 billion, the allotment volume of the second additional 12-month refinancing operation, which, at the end of September, was likewise allotted at a fixed interest rate of 1%, was significantly smaller than that of the first transaction of this type at the end of

June (€442.2 billion). The number of participating banks also fell significantly from 1,121 for the first 12-month tender to 589. This indicates that the general liquidity situation of euro-area banks can currently be considered to be extraordinarily sound as a result of the Eurosystem's generous refinancing measures and the introduction of a covered bond purchase programme. Furthermore, euro money market rates are at a historically low level across all maturities. Compared with the interest rate response after the first 12-month tender, rates moved down only slightly after the second operation of this type had been allotted.

Overnight rate quoted at just over the deposit facility

This applies particularly to the overnight rate (EONIA). Apart from some short-term increases resulting mostly from liquidity-absorbing fine-tuning operations at the end of the minimum reserve periods, the EONIA has remained almost invariably at around 0.35 percentage point since early July 2009, just about 0.1 percentage point above the interest rate on the Eurosystem's deposit facility. At the same time, trading volumes underlying the EONIA were tending to rise again, albeit with, in some cases, strong volatility.

Money market interest rates in the euro area



1 Monthly averages. — **2** Only on 8 October 2008 2.75%. — **3** Three-month Euribor less three-month Eurepo. — ● Average from 1-16 November 2009.

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Longer-term money market rates down only slightly

In the longer-term maturity segment of the euro-area money market, too, rates were largely stable at a very low level, after quoted interest rates had gone down further initially at the beginning of the third quarter in connection with the first 12-month tender. In the unsecured market segment, the rates for all maturities up to and including six months are currently under the 1% mark and thus below the interest rate at which banks can obtain liquidity from the Eurosystem in secured refinancing transactions. The unsecured three-month interest rate (3M Euribor) stands currently at 0.7%, ie more than 0.3 percentage point below the rate quoted in early July. In the same period, its secured counterpart (3M Eurepo) fell by only 0.2 percentage point. As this article went to press, the spread between both interest rates, which can be interpreted as a risk indicator for the money market, thus

Money market management and liquidity needs

During the three reserve maintenance periods between 8 July and 13 October 2009, euro-area credit institutions' need for central bank liquidity determined by autonomous liquidity factors fell by €5.5 billion in net terms. The volume of banknotes in circulation, which continued to grow at a strong rate, recorded a new high during the period under review when it reached €775 billion on 7 August 2009 and absorbed liquidity in the amount of €5.7 billion. General government deposits with the Eurosystem increased slightly by €1.1 billion which also resulted in liquidity being absorbed. The level of these government deposits remained high. If the net foreign reserves and the other factors are taken together, a move which eliminates liquidity-neutral valuation effects, there was, by contrast, a decline of €12.3 billion in the liquidity needs of banks over the three maintenance periods. This was mainly caused by Eurosystem purchases of financial assets which are unrelated to monetary policy. It should be noted that this does not include the purchase programme for covered bonds and foreign exchange swaps as these are classified as monetary policy operations. The liquidity needs arising from the minimum reserve requirement declined by €4.4 billion over the three reserve maintenance periods and were met by credit institutions without any problems.

Around one year after tensions had escalated on the money market, Eurosystem liquidity management continued to be focussed primarily on supporting the functioning of the money market through the ample provision of liquidity. All refinancing operations continued to be carried out as fixed-rate tenders with full allotment with no changes to their maturity structure and frequency (see table on page 28). This included, in particular, the allotment of the second twelve-month tender at the end of September 2009. Additionally, as part of a purchase programme for covered bonds (such as Pfandbriefe) agreed at the meeting of the ECB Governing Council on 7 May 2009, the Eurosystem began purchasing such securities at the beginning of July. One of the aims of the programme is to promote the sustained fall in money market rates and to ease refinancing conditions for credit institutions and enterprises. The positive momentum of the purchase programme was evidenced in the reporting period in the fact that issues of covered bonds in the euro area increased perceptibly as well as by the fact that, according to market participants, narrower spreads were seen on the secondary market.

In the July-August reserve period, the ample liquidity supply, in particular as a result of the allotment of the first twelve-month tender in June 2009 with a value of €442 billion (the largest volume ever allotted in a refinancing operation) ensured that the EONIA was kept low and stable at an average of 0.36%. The only exception was on the last day of the reserve period when the Eurosystem carried out a liquidity-absorbing fine-tuning operation with a volume of €238 billion and the EONIA stood at 0.47%. At around €30 billion, average EONIA turnover was low during the maintenance period. Although credit institutions continually reduced their liquidity demands in the main and longer-term refinancing operations, at an average of €265 billion, a significantly larger amount of liquidity was available to them in the reserve period than was required to meet the regular liquidity needs arising from autonomous factors such as banknotes and the reserve requirement.

In the August-September reserve period there was a continuation of this comparatively stable development in the EONIA, with an average rate of 0.35%, one basis point below the average of the previous period. The overnight rate continued to be oriented to the deposit facility rate of 0.25% as a result of the generous liquidity provision which was provided entirely according to the banks' demands. Even at the end of the month there was not the "usual" increase. Only at the end of the reserve period on 8 September 2009, did the combined effect of the more restricted interbank trade which is always observable on the last day of the period and the liquidity-absorbing quick tender with a volume of €195 billion result in the EONIA climbing to 0.54%.

The focus of the 35-day September-October reserve period was the allotment of the second twelve-month tender at the fixed rate of 1.00%, the same rate as for the main refinancing operations. The fact that banks bid €75 billion in the second tender, much less than in the first twelve-month tender, was viewed by the mar-

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kets as a sign of some easing. However, it must be taken into account that many banks covered themselves with a significant amount of central bank liquidity in the first tender and will be able to gradually make use of this liquidity until June 2010. A certain degree of saturation with respect to twelve-month refinancing, which obviously requires corresponding eligible assets, was also evidenced by a halving in the number of bidders at 589 (compared with 1,121 in June). Although the total refinancing volume after the allocation of this tender increased, at €734 billion it was clearly below the record levels of almost €900 billion in early summer. In the remaining tenders of the reserve period, banks reduced their liquidity demands – as they had in the run-up to the second twelve-month tender – and excess liquidity averaged €164 billion for the period (compared with €189 billion in the previous period). Correspondingly, recourse to the deposit facility also decreased, averaging €110 billion compared with €137 billion in the preceding period and €185 billion in the period before this. Thus, in aggregate terms, the banks made progress with respect to their liquidity management, meaning that the Eurosystem became somewhat less active as an intermediary in the money market. This pattern was also reflected in the increased EONIA turnover which stood at €36 billion on average in September, compared with an average of €32 billion in August. In addition, an increase in turnover on Eurex Repo's Euro GC Pooling for overnight money from €8.7 billion on a daily average to €9.4 billion in both months was an indication of a slight revival in the interbank market, this without taking into account the stronger preference for secured O/N transactions which intensified during the crisis.

In the case of the second twelve-month tender, a special liquidity situation arose at those banks which wanted to restructure their refinancing from weekly tenders to twelve-month refinancing (the last weekly tender of the month settled on 30 September but the funds from the twelve-month tender were only available on 1 October). However, this liquidity gap was comparatively small, with recourse to the marginal lending facility of €4.9 billion (particularly when compared with a similar situation in the case of the first twelve-month tender, when recourse to overnight central bank credit amounted to €29 billion). The fact that this liquidity gap also coincided with the end of the quarter in September was ultimately reflected in an increase in the EONIA to 0.55%. If the two upward outliers are excluded – the second was on the last day of the reserve period – the EONIA was 0.35% on average during this period.

Overall, the generous supply of liquidity ensured that the unsecured overnight money markets were very stable throughout the entire period under review and EONIA fixings took place largely within a narrow range.

Factors determining bank liquidity [1]

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

Item	2009 8 July to 11 Aug	12 Aug to 8 Sep	9 Sep to 13 Oct
I Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors			
1 Banknotes in circulation (increase: –)	– 7.7	+ 1.7	+ 0.3
2 General government deposits with the Eurosystem (increase: –)	+ 4.0	+ 8.2	– 13.3
3 Net foreign reserves [2]	– 23.5	– 6.0	– 6.2
4 Other factors [2]	+ 38.8	+ 6.5	+ 2.7
Total	+ 11.6	+ 10.4	– 16.5
II Monetary policy operations of the Eurosystem			
1 Open market operations			
(a) Main refinancing operations	– 127.3	– 19.3	+ 4.3
(b) Longer-term refinancing operations	+ 189.1	– 48.6	– 28.5
(c) Other operations	– 9.4	+ 9.2	+ 11.5
2 Standing facilities			
(a) Marginal lending facility	– 1.0	– 0.0	+ 0.0
(b) Deposit facility (increase: –)	– 65.4	+ 48.4	+ 27.1
Total	– 14.0	– 10.3	+ 14.4
III Change in credit institutions' current accounts (I + II)	– 2.3	– 0.0	– 2.2
IV Change in the minimum reserve requirement (increase: –)	+ 2.1	+ 0.1	+ 2.2

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
08.07.09	MRO (FRT)	7	106.4	165.4	1.00	100.00	–	1.00	397
08.07.09	S–LTRO (FRT)	35	38.3	–	1.00	100.00	–	1.00	86
09.07.09	S–LTRO (FRT)	91	3.0	–	1.00	100.00	–	1.00	28
09.07.09	S–LTRO (FRT)	189	9.1	–	1.00	100.00	–	1.00	56
15.07.09	MRO (FRT)	7	100.3	286.3	1.00	100.00	–	1.00	389
22.07.09	MRO (FRT)	7	88.3	285.3	1.00	100.00	–	1.00	396
29.07.09	MRO (FRT)	7	94.8	269.3	1.00	100.00	–	1.00	382
30.07.09	LTRO (FRT)	91	9.5	–	1.00	100.00	–	1.00	68
05.08.09	MRO (FRT)	7	80.8	262.8	1.00	100.00	–	1.00	348
11.08.09	FTO (–)	1	– 238.4	–	0.80	100.00	0.70	1.00	159
12.08.09	MRO (FRT)	7	73.6	105.6	1.00	100.00	–	1.00	320
12.08.09	S–LTRO (FRT)	28	30.7	–	1.00	100.00	–	1.00	90
13.08.09	S–LTRO (FRT)	91	13.0	–	1.00	100.00	–	1.00	20
13.08.09	S–LTRO (FRT)	182	11.9	–	1.00	100.00	–	1.00	53
19.08.09	MRO (FRT)	7	76.1	223.1	1.00	100.00	–	1.00	330
26.08.09	MRO (FRT)	7	77.5	193.7	1.00	100.00	–	1.00	325
27.08.09	LTRO (FRT)	91	8.3	–	1.00	100.00	–	1.00	35
02.09.09	MRO (FRT)	7	72.1	174.1	1.00	100.00	–	1.00	286
08.09.09	FTO (–)	1	– 195.1	–	0.80	100.00	0.73	1.00	157
09.09.09	MRO (FRT)	7	93.3	105.8	1.00	100.00	–	1.00	311
09.09.09	S–LTRO (FRT)	28	10.6	–	1.00	100.00	–	1.00	45
10.09.09	S–LTRO (FRT)	91	3.2	–	1.00	100.00	–	1.00	14
10.09.09	S–LTRO (FRT)	182	3.7	–	1.00	100.00	–	1.00	23
16.09.09	MRO (FRT)	7	87.8	152.8	1.00	100.00	–	1.00	318
23.09.09	MRO (FRT)	7	85.0	163.5	1.00	100.00	–	1.00	332
30.09.09	MRO (FRT)	7	66.8	132.3	1.00	100.00	–	1.00	244
01.10.09	S–LTRO (FRT)	364	75.2	–	1.00	100.00	–	1.00	589
01.10.09	LTRO (FRT)	77	2.8	–	1.00	100.00	–	1.00	19
07.10.09	MRO (FRT)	7	62.6	180.1	1.00	100.00	–	1.00	224
08.10.09	S–LTRO (FRT)	98	1.1	–	1.00	100.00	–	1.00	8
08.10.09	S–LTRO (FRT)	182	2.4	–	1.00	100.00	–	1.00	22
13.10.09	FTO (–)	1	– 169.7	–	0.80	100.00	0.74	1.00	160

* For more information on the Eurosystem's operations from 8 April 2009 to 7 July 2009, see Deutsche Bundesbank, Monthly Report, August 2009, p 29. — 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.

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narrowed by just under 0.2 percentage point to 0.28 percentage point. The depo-repo spread is therefore almost 1.6 percentage points below the level recorded immediately after the intensification of the financial market turmoil in autumn 2008.

Monetary developments in the euro area

Further deceleration of monetary expansion

Monetary expansion in the euro area continued to slow in the reporting quarter. In seasonally adjusted and annualised terms, the broad monetary aggregate M3 grew by almost 1% in the third quarter and was thus well down on the already weak rate of 2% recorded in the second quarter. The three-month average of the annual growth rates of

M3 showed a further fall to 2.5% between July and September on the back of 4.1% in the second quarter, reaching its lowest level since the launch of monetary union.

Highly liquid M3 components in particular demand

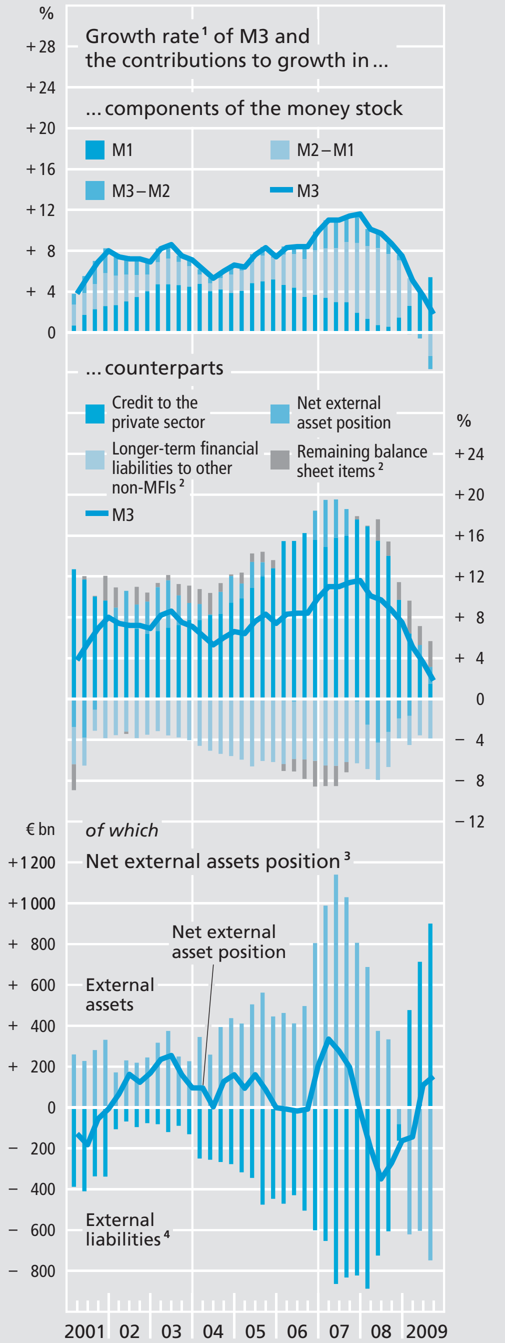
As in the two previous quarters, the fact that, currently, investments with a maturity of up to two years have a comparatively small interest rate advantage compared with overnight deposits led to shifts from short-term time deposits remunerated at market rates to the most liquid components of M3. Consequently, there was an extremely large rise in overnight deposits in the reporting quarter, at a seasonally adjusted and annualised three-month rate of 19%. This exceeded the 16½% recorded in the previous quarter, which was already a high figure. As in the second quarter, it was mainly households and non-financial corporations which invested in overnight deposits. Currency in circulation rose by just under 7½% compared with an increase of almost 4% in the previous quarter. Overall, the narrow monetary aggregate M1 accelerated further to 17% in the July to September period, compared with 14% between April and June.

Net reduction in short-term deposits other than overnight deposits ...

Conversely, holdings of other short-term deposits diminished by a seasonally adjusted and annualised three-month rate of 10% after having already shrunk by 9% in the first quarter and 7% in the second quarter. While demand for short-term savings deposits (redeemable at up to three months' notice) continued to be strong as a result of portfolio restructuring, it fell far short of offsetting the decline in short-term time deposits (with an agreed maturity of up to two years) in the

Components and counterparts of the money stock in the euro area

Seasonally adjusted, quarterly



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

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period under review. The latter fell sharply by a seasonally adjusted and annualised 27% after having already fallen by 20% in the previous quarter. As in the two preceding quarters, the decline was due mainly to households. By contrast, the reduction in short-term time deposits by other financial intermediaries and non-financial corporations was not as pronounced as in the second quarter.

... and marketable instruments

Holdings of marketable instruments fell by not quite 14½% in annualised terms between July and September, compared with a 5½% decrease in the second quarter. In particular, there was a sharp decline in short-term debt securities of monetary financial institutions held by non-banks. This development has been evident since the fourth quarter of 2008 and, alongside interest rate and risk factors, reflects, not least, the Eurosystem's extensive liquidity-providing operations. As a result of these, the European banking system is currently being supplied with ample liquidity in the maturity segment of up to one year, and mature debt instruments consequently do not necessarily need to be rolled over. In the reporting quarter, repo transactions, which mainly result from secured interbank operations, also declined. If this development continues, it may be a sign of easing tensions on the interbank market. Money market fund shares/units were the only component of marketable instruments to show an overall positive development in the period under review. Following considerable reductions in the previous quarter, demand for this component rose again slightly in the reporting quarter.

Subdued lending to the private sector

The fact that lending was notably subdued contributed to the weak underlying monetary growth in the reporting quarter. The seasonally adjusted and annualised three-month rate for loans to domestic private non-banks was just under -1%, compared with ½% in the previous quarter. Even taking into account credit institutions' securitisation activities, which typically lead to a statistical underreporting of banks' actual lending, there was a net decrease in loans to the private sector. After adjustment for this effect – which had perceptibly less impact in the reporting quarter – loans to domestic private non-banks fell by ½% in seasonally adjusted and annualised terms in the third quarter, compared with an increase of almost 1½% in the preceding three-month period.

Decline in lending to other financial intermediaries...

With the exception of households, the further decline in lending affected all sectors of domestic private non-banks. Lending to other financial intermediaries, which had driven credit growth up to a seasonally adjusted and annualised rate of 23% in the second quarter, fell by a corresponding rate of just over 8% between July and September. The volatility of these movements has to be seen in connection with the particular role played by other financial intermediaries in banks' refinancing and lending transactions, above all in reverse repo transactions. In these transactions, banks issue a securitised loan to a financial service provider in the other financial intermediaries sector. The financial service provider then lends the liquidity raised to other banks against collateral. These transactions ultimately constitute indirect interbank operations. A reduction in this type of lending is therefore not *per se* accompanied by restricted lending to the private non-banking sector.

... and non-financial corporations

At a seasonally adjusted and annualised quarterly rate of not quite -2%, there was another perceptible decline in loans to non-financial corporations; in the previous quarter, they shrank at a corresponding rate of 3½%. The current decline was caused mainly by the sharp fall in loans with a maturity of up to one year; the decline in medium-term loans (with a maturity of one to five years) also accelerated in the reporting quarter, however. By contrast, there was a clear increase in long-term loans (with a maturity of over five years).

By contrast, considerable growth in loans to households

Meanwhile, the positive development in loans to households was reinforced. This was chiefly a result of growth in housing loans, which are the most important component of loans to households in terms of quantity. These increased at a seasonally adjusted and annualised quarterly rate of 2½% between July and September, compared with just under ½% in the second quarter. The low interest rate level and moderate growth in house prices seem to have revived demand for residential real estate in the euro area. In the reporting quarter, consumer loans and other lending to households also grew by almost 1½% and 2½%, respectively, in seasonally adjusted and annualised terms, compared with -3% and just under 3½% in the previous quarter.

Significant securities acquisitions by banks

Since autumn 2008, overall credit provided by banks in the euro area has been characterised more by the acquisition of securitised assets rather than the flows of loans. In the reporting quarter, banks increased solely their overall holdings of securities, principally of public sector issuers. In seasonally adjusted and annualised terms, securitised lending to public debtors rose by almost 17½% in the third quarter, compared with 21½% in the previous three months. This rise can be attributed to both an increase in the financing needs of the public sector and to the comparatively high attractiveness of government bonds at present owing to the issuers' good credit quality, the high liquidity of these securities, and the spread between short-term refinancing costs and the yield on longer-term government paper. However, there was also an increase in holdings of securities issued by the private sector in the euro area, which are generally riskier. These grew at a seasonally adjusted and annualised rate of almost 8% in the third quarter, compared with more than 10% in the previous quarter.

Perceptible rise in banks' net external position

As in the previous quarter, the reduction in domestic MFIs' liabilities to residents outside the euro area was more pronounced than the corresponding reduction in assets in the reporting period. In the third quarter of 2009, the net external assets of the euro-area MFI sector rose by €47.3 billion in seasonally adjusted terms and thus, taken in isolation, had an expansionary effect on monetary growth.

Strong rise in longer-term investment at banks

By contrast, monetary growth tended to be slowed by persistently strong formation of MFI longer-term financial liabilities. Monetary capital in the euro area rose by almost 7% in seasonally adjusted and annualised terms on the back of 8% in the previous quarter.

Although banks increased their capital and reserves only slightly in the reporting quarter, they were evidently in a better position than in the two previous quarters to raise funds from non-banks by issuing debt securities with longer maturities. This may be due, not least, to the Eurosystem's covered bond purchase programme, which had a stimulatory effect on the relevant bond markets. Domestic non-banks' high uptake of long-term time deposits also boosted monetary capital. While households and non-financial corporations again lent further momentum to the topping-up of these deposits given their high medium-term to longer-term yields compared with interest rates in the short-term segment, these deposits grew at a much slower pace in the case of other financial intermediaries. Since growth of these deposits in the previous three quarters is to be seen in connection with asset securitisation via banks' special-purpose financing vehicles, this development may indicate that the significance of such transactions declined in the euro-area banking sector in the reporting quarter.

No medium-term price risks from a monetary perspective

Overall, underlying monetary dynamics – in other words, those developments in monetary growth which are ultimately relevant to inflation – have been slowing considerably since the beginning of the year. M3 growth was subdued in the quarter under review, and lending to the domestic private sector declined on balance. As in the preceding quarter, inflation forecasts based on monetary data, taken together, indicate that there is no pronounced risk to price stability for the next three years. Nevertheless, the dispersion of the forecast values has increased significantly on the quarter. This highlights the fact that there is still a high degree of uncertainty associated with such inflation forecasts.

Deposit and lending business of German banks with domestic customers

Noticeable reduction in domestic investors' balances at German banks

In the third quarter of 2009, domestic investors considerably reduced their deposits held by German banks. After growing at a seasonally adjusted and annualised three-month rate of 2½% in the second quarter, these deposits fell at a corresponding rate of 2% between July and September. There were heterogeneous developments across types of deposit, however. Short-term time deposits remunerated at close to market rates (with an agreed maturity of up to two years), which had long been becoming considerably less attractive owing to their declining remuneration, plummeted at a seasonally adjusted and annualised three-month rate of almost -51%, the largest fall since the beginning of monetary union. Households, in particular, reduced these balances extremely sharply for the third consecutive quarter. By contrast, there was a sharp expansion of holdings of overnight deposits. Growing at a seasonally adjusted and annualised quarterly rate of 22½%, they were only slightly down on the previous quarter (26%), with strong growth rates recorded primarily by non-financial corporations and households. The latter also purchased considerable quantities of short-term savings deposits (redeemable at up to three months' notice), which boosted the growth of this type of deposit. In seasonally adjusted and annualised terms, short-term savings deposits increased by more than 16% between July and September, compared with 9½% in the second quarter.

Great interest in long-term savings deposits again

Despite the continuing steep yield curve, which spurred substantial growth in German banks' long-term deposit business with domestic customers in the second quarter, there were no shifts in favour of long-term deposit types on balance in the third quarter. Although long-term savings deposits (redeemable at more than three months' notice) rose by a seasonally adjusted and annualised rate of 15½% in the third quarter, the quantitatively more significant long-term time deposits (with an agreed maturity of over two years) shrank by a similar volume in terms of their amount during the same period to a corresponding three-month rate of just over -2%. This rate had been almost 11% in the previous quarter. This reduction was driven mainly by other financial intermediaries, which strongly increased their holdings of long-term time deposits in June, in particular. A clear reduction in these balances was, however, evident as early as July. By contrast, households looking to benefit from the comparably high yields on these instruments once again fuelled very strong demand for this type of deposit in the reporting quarter.

Perceptible net reduction in lending by German banks

Following a dynamic seasonally adjusted and annualised quarterly rise of almost 5½% in overall lending by domestic credit institutions between April and June, primarily as a result of an extremely sharp increase in securitised lending to the private sector, there was an obvious net reduction in lending in the third quarter. Consequently, the corresponding growth rate of all outstanding loans fell to nearly -1½% in the reporting quarter. There were, initially, net redemptions across the board in July and August; however, German banks began lending to their domestic customers again in September. The majority of this lending was to financial corporations, however.

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

€ billion

Item	2009 July to Sep	2008 July to Sep
Deposits of domestic non-MFIs 1		
Overnight	34.6	– 12.0
With agreed maturities		
of up to 2 years	– 63.5	47.8
of over 2 years	3.3	– 1.4
Redeemable at notice		
of up to 3 months	12.2	– 11.5
of over 3 months	3.2	– 2.7
Lending		
to domestic enterprises and households		
Loans	– 10.8	17.4
Securities	– 7.0	31.4
to domestic government		
Loans	3.6	– 4.5
Securities	4.7	– 12.3

* 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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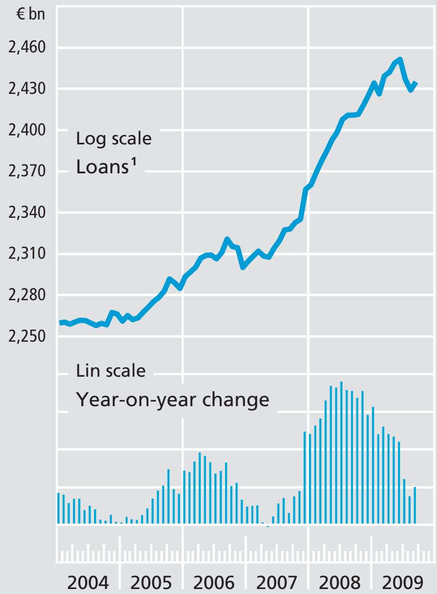
Decrease in loans to the private sector

Loans to the private sector fell at a seasonally adjusted and annualised quarterly rate of more than 2½% in the third quarter on the back of 2% growth in the period between April and June. In terms of the maturity spectrum of loans to private borrowers, it was again mainly the short-term segment with maturities of up to one year which was scaled back.

Loans to domestic enterprises and households

Seasonally adjusted



1 End of month; adjusted for statistical changes.

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Further drop in unsecuritised lending to non-financial corporations

Following marked net redemptions of credit issued by German banks to domestic non-financial corporations in the second quarter of 2009, there was a further seasonally adjusted and annualised 3½% reduction in their volume in the third quarter. Once again, this was due to short-term loans. They were reduced by 22% in seasonally adjusted and annualised terms following a reduction at a corresponding rate of 19½% in the second quarter. By contrast, positive seasonally adjusted and annualised three-month rates were recorded for medium-term and long-terms loans with maturities of more than one year and up to five years, and over five years. While the latter diminished at a corresponding rate of just under 1% in the previous quarter, they grew by 1½% in the reporting period. In the current setting, the increase in long-term loans is likely to particularly reflect borrower preferences. This contradicts speculation that supply-side restrictions are the main reason for subdued lending to non-financial corporations.[1]

Marked increase in loans to households

Unlike lending to non-financial corporations, lending to households was robust in the third quarter. In seasonally adjusted terms, all loans to households rose at a faster rate between July and September than at any time in the previous three years. The annualised three-month rate was, nevertheless, just under 1% compared with not quite ½% between April and June. As in the previous quarters, this development was driven primarily by consumer credit, which was issued on a large scale by regional banks in the reporting period. In addition, there was a significant rise in loans for house purchase in the third quarter.

Clear reduction in outstanding amount of private sector securitised lending

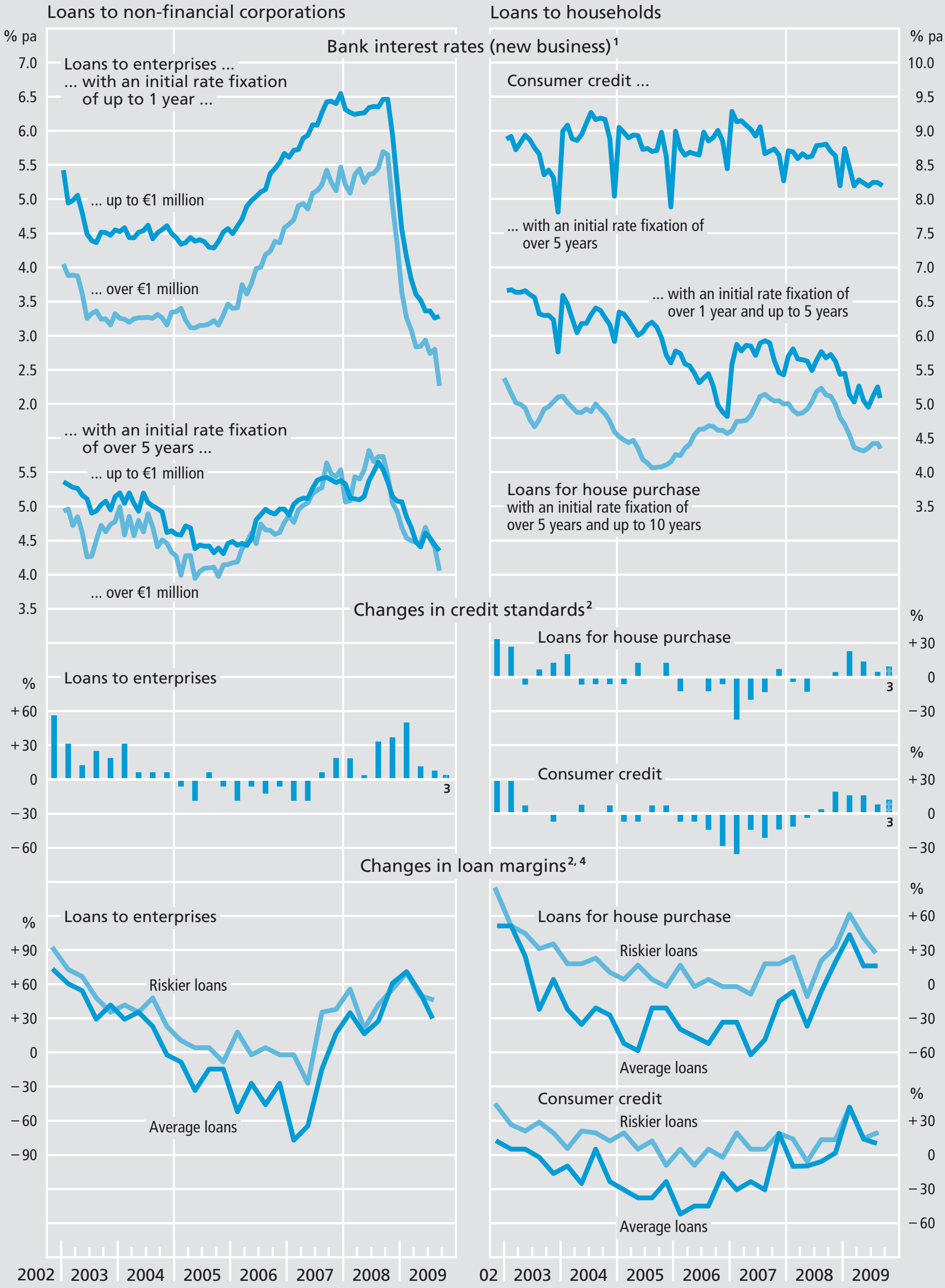
By contrast, securitised lending to the private sector fell noticeably in the third quarter as a result of weak securitisation activity. In seasonally adjusted and annualised terms, it fell by 8½% following a corresponding rate of over 26½% in the previous quarter owing to extremely strong growth in June.

Increased lending to general government

In contrast to weak private sector lending, the volume of overall lending to general government increased considerably. Despite obvious reductions towards the middle of the third quarter, the volume of lending to general government increased between July and September at a faster rate than at any time since the

1 See Deutsche Bundesbank, Developments in lending to the German private sector during the global financial crisis, Monthly Report, September 2009, pp 22-24.

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 2009 Q4. — 4 Reduced scale.

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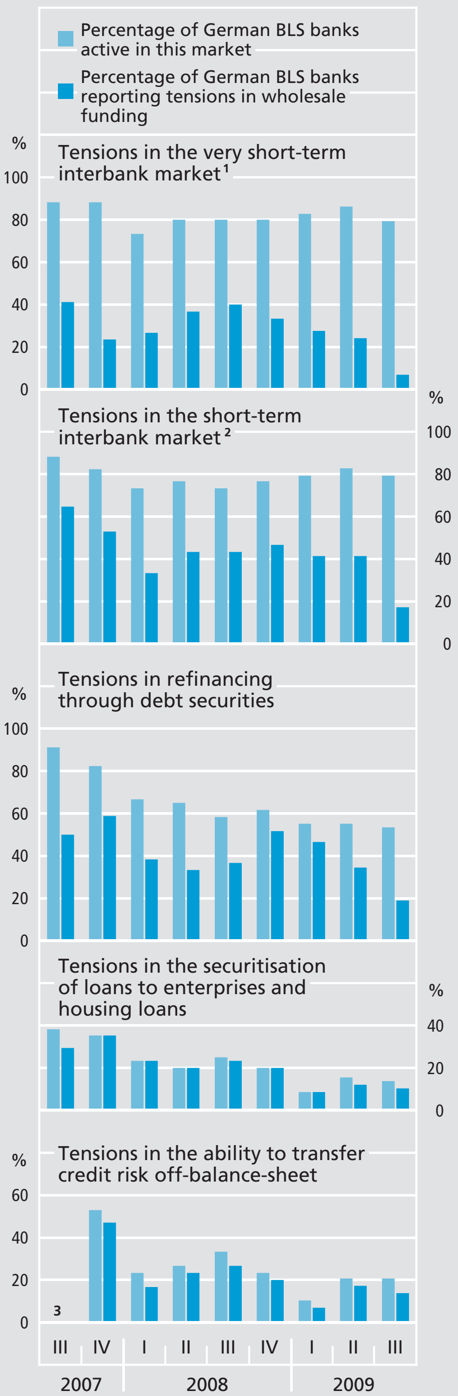

1 Maturity of up to one week. — 2 Maturity of over one week. — 3 Not asked in 2007 Q3.

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third quarter of 2004. In seasonally adjusted and annualised terms, it increased by 11%. In July, this growth was initially based solely on an expansion of unsecuritised loans, while, in September, only securitised lending showed positive growth. Over the third quarter as a whole, unsecuritised lending rose at a seasonally adjusted and annualised three-month rate of 4%, while the securitised lending grew at a corresponding rate of 27½%.

Only slight tightening of credit conditions

According to the Bank Lending Survey, weak domestic lending to the private sector in the third quarter is likely to have been mainly cyclical. Only a few surveyed bank managers stated that they had tightened their standards for loans to non-financial corporations and these adjustments were made principally on the basis of risk perception and were driven, in particular, by industry and firm-specific factors. The rise in the cost of holding capital reserves played a certain role only for loans to large enterprises. However, margins for loans to enterprises were expanded again significantly in the third quarter, irrespective of the size of enterprise. At the same time, the Bank Lending Survey showed a marked increase in enterprises' borrowing requirements. This is likely to reflect only a limited actual increase in the aggregate demand for credit, however. Shifts within the market to, above all, smaller institutions less affected by the financial crisis still seem to be of greater significance for the German aggregate.[2]

2 Shifts in demand from large to small banks may lead to the Bank Lending Survey showing an aggregate increase in demand as the individual data are incorporated into the calculation of net balances on an unweighted basis and the number of smaller institutions is greater in the survey sample in line with the specific circumstances in Germany.

As with loans to enterprises, the credit standards for households were tightened only by a very limited number of banks participating in the survey. Margin adjustments in this market segment also lagged behind those in the commercial banking segment. With regard to the relevance of supply-side determinants, the data provided by survey participants in Germany are broadly consistent with the data for the euro area as a whole.

The survey round for the third quarter of 2009 again contained a number of additional questions on the specific impact of the financial market crisis on participating banks' credit supply policy. The responses indicated that wholesale funding problems had eased noticeably since the previous quarter. This was especially true of lending in the very short-term and short-term money market as well as lending through debt securities. According to the survey participants, the markets for securitisations and for the off-balance-sheet transfer of credit risk, which are used by only a very few German banks, were still tense in the third quarter. Furthermore, almost half of the surveyed banks were still facing constraints owing to capital restrictions, which was also reflected in lending in some cases.

Bank lending rates continue to decline

Despite the strong expansion of margins reported in the Bank Lending Survey, German credit institutions also passed on part of their reduced refinancing costs to domestic private customers in the reporting quarter. In turn, the cost of loans to enterprises was reduced considerably in some cases during the same period. For short-term loans, the reporting institutions charged just 3.3%, or 2.3%, according to loan volume. At 4.3%, or 4.1%, the cost of long-term loans to domestic non-financial corporations was likewise down on the quarter at the end of September. Lending rates for households fell across the board in the previous quarter; the rate for long-term loans for house purchase still averaged 4.4% at the end of September.