Monetary policy and banking business

Interest rate policy and the money market

Key policy rates unchanged

The economic recovery in the euro area continued during the second quarter of 2010. At the same time, price developments over the time horizon relevant to monetary policy are expected to remain subdued owing to the ongoing marked capacity underutilisation and muted monetary growth. This and the, at times, considerable tensions on the financial markets as well as the still solidly anchored inflation expectation prompted the Governing Council of the ECB to keep the Eurosystem's key policy rates on hold during the second quarter of 2010. In the second quarter, the Eurosystem's main refinancing operations were thus once again conducted as fixed-rate tenders with full allotment and at a fixed interest rate of 1%. The interest rate for recourse to the marginal lending facility remains stable at 1.75%, while the interest rate on the deposit facility stands at 0.25%.

Purchase programme for public and private debt securities

At the beginning of May, the escalating government debt crisis in Greece provoked substantial turmoil in a number of European financial market segments. In order to prevent contagion, the Governing Council of the ECB, on the second weekend in May, resolved to purchase public and private debt securities from particularly hard hit market segments. This Securities Markets Programme is predicated on the credible commitment on the part of the fiscal bodies concerned to implement adequate consolidation measures. Parallel to this, the Governing Council announced that it would regularly re-absorb the liquidity injected through the purchase of

debt securities; since mid-May, this has been instrumented once a week by means of a one-week deposit tender.

Additional measures to guarantee the liquidity supply

Moreover, to guarantee the continued supply of sufficient liquidity to the banking system, the Governing Council decided to return to conducting the regular three-month longer-term refinancing operations (LTROs) as fixed-rate tenders with full allotment for the period up to 29 September 2010 and to carry out an interest-indexed six-month tender on 12 May. In addition, the Eurosystem reactivated swap transactions with the US Federal Reserve in order to ensure the provision of US dollars to the euro-area banking system through seven and 84-day operations.

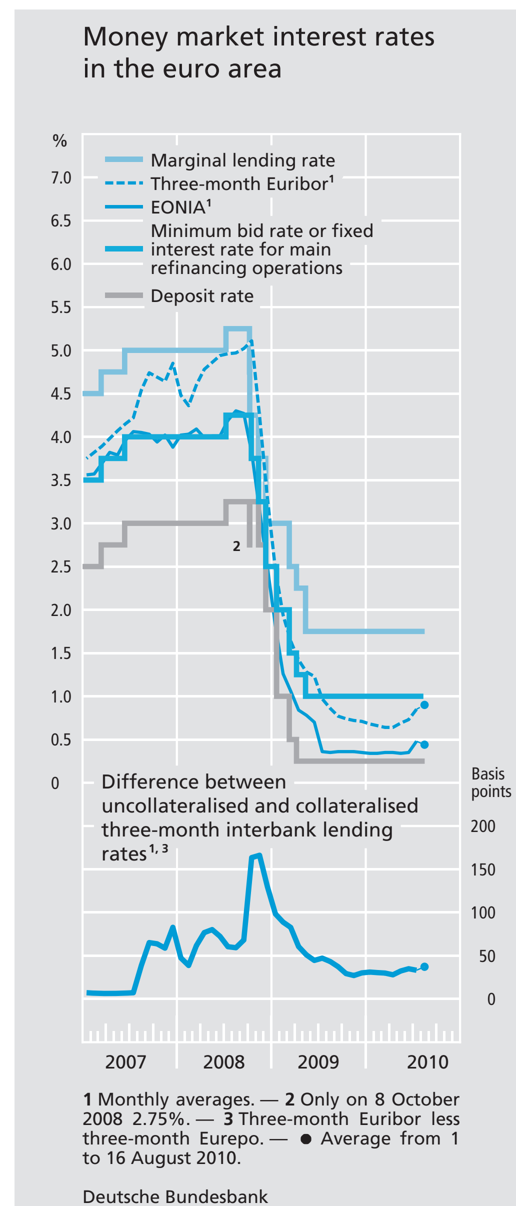
CBPP expired

By contrast, on 30 June 2010, the Covered Bond Purchase Programme (CBPP) was concluded on schedule, having reached its declared target purchase volume of €60 billion.

Stabilisation tendencies in the euro money market situation, ...

Thanks to the measures adopted in support of liquidity policy, the European money market barely reacted to the renewed tensions arising from the sovereign debt crisis. With the exception of some short-term spikes following liquidity-absorbing fine-tuning operations on the last day of each reserve maintenance period and the last trading day of the first half of the year, the overnight rate (EONIA) remained broadly constant in the second quarter at around 8 basis points above the interest rate on the Eurosystem's deposit facility. Longer-term money market rates have been edging upwards since the end of April. When the first one-year long-

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 to 16 August 2010.

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term refinancing operation matured on 1 July 2010, as a result of which a total of €442.2 billion was withdrawn from the banking system, the overnight interest rate initially rose perceptibly. It then eased back again at the end of the reserve maintenance period and, at 0.45%, stood 20 basis points above the Eurosystem's deposit facility rate as this report went to press. At the same time, trading activity on the overnight money market in-

Money market management and liquidity needs

During the three reserve maintenance periods from 14 April to 13 July 2010, euro-area credit institutions' need for central bank liquidity determined by autonomous liquidity factors grew by €31.5 billion in net terms. This was largely owing to the increased demand for banknotes (€20.1 billion). Furthermore, the expansion in general government deposits withdrew liquidity from the banking system (€12.9 billion). Only net foreign reserves and the other factors taken together, which eliminate liquidity-neutral valuation effects, showed a decline in the level of liquidity needs (€1.5 billion) during the period under review. In addition to the development of autonomous factors, a rise in the minimum reserve requirement (by a total of €1.5 billion) also contributed to the increase in demand for central bank liquidity.

As in previous months, the Eurosystem continued its policy of providing a generous supply of liquidity during the period under review in order to support the smooth functioning of the money market and to satisfy the demand for central bank liquidity from credit institutions, even if this exceeded the benchmark level arising from autonomous factors and the minimum reserve requirement. In April 2010, the Eurosystem initially continued the steps it had introduced in the previous months to phase out the non-standard monetary policy measures and – as it announced at the start of March 2010 – carried out a regular three-month variable rate tender for the first time since September 2008. At the same time, the Governing Council had decided that both the main refinancing operations and the special tenders with a maturity of one reserve maintenance period would continue to be carried out as fixed-rate tenders with full allotment until at least mid-October 2010. After its initiation, the departure from the non-standard monetary policy measures was discontinued in early May 2010, however, due to the worsening sovereign debt crisis, which was causing severe tensions in certain market segments. This prompted the Council to approve a number of non-standard measures on 9 May: the Eurosystem announced that it would intervene in euro area public and private debt securities markets (Securities Markets Programme, SMP), offer the regular three-month tenders as fixed-rate tenders with full allotment again in May and June, carry out a further six-month tender with full allotment and resume US dollar liquidity providing operations. In addition to these decisions and the implementation of these steps, the period under review was also affected by the expiration of the first 12-month tender, in which €442 billion matured on 1 July. Due to supportive Eurosystem measures, however, this passed off smoothly.

During the three reserve periods under review, the refinancing volume weighting in the Eurosystem shifted from longer-term refinancing operations to main refinancing operations (see table on page 27), mainly because of the liquidity outflow from the maturing 12-month tender. On average, the net long-term volume decreased by just over €77 billion, while main refinancing volume increased by just under €90 billion. Moreover, credit institutions received additional liquidity from the Eurosystem's purchase programme for covered bonds. The Eurosystem ended this programme at the end of June 2010 as intended; the target nominal volume of €60 billion (€61.1 billion on the balance sheet) had been reached. As planned, the balance sheet holdings had grown by €14.7 billion during the period under review. Although the Eurosystem generated debt securities with a total volume of around €60 billion from the newly introduced SMP, by the end of the period under review the introduction of weekly, liquidity absorbing fine-tuning operations with a one-week maturity had virtually re-absorbed the resulting liquidity supply. The volume absorbed weekly by the Eurosystem almost always matched the securities holdings booked from this SMP at the end of the previous week in each case.

The additional provision of liquidity, which exceeded the increase in liquidity needs arising from autonomous factors and the reserve requirement, led on balance to a higher degree of recourse to the deposit facility (by around €30 billion) during the reserve periods described. By contrast, the marginal lending facility continued to be used sparingly. Overnight rates were also influenced by the comfortable supply of liquidity once again. EONIA, as a reference rate for unsecured overnight deposits, remained almost constantly in the range between 0.32% and 0.35% during the period under review until the maturity of the first 12-month tender on 1 July 2010, and so was close to the deposit facility rate of 0.25%. EONIA was only set at higher rates of up to 0.75% on each of the final reserve period days (due to the liquidity absorbing fine-tuning operations at the end of the period), at half-year end and at the maturity of the 12-month tender (owing to the reduced liquidity surplus).

During the April-May 2010 reserve period, a liquidity providing open market operation was carried out by variable-rate tender for the first time in just over one and a half years. The regular three-month tender was conducted as a variable-rate tender at the end of April, but at the same time the main refinancing rate was set as a minimum bid rate to prevent interest rate bids that were too low for the prevailing comfortable liquidity position. Interest from credit institutions in this operation was low, with a bid volume of €4.8 billion. As the Eurosystem had pre-announced an indicative allotment amount of €15 billion, all bids could be allotted at their corresponding bid rates. The continued abundance of central bank liquidity, which was unaffected by this, led to an average level of recourse to the deposit facility (€218 billion compared with €201 billion in the previous period). The amply liquidity supply restricted

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EONIA turnover, which was just €26.1 billion on average over the period and therefore remained at a low level (€27.2 billion in the previous period; by comparison: yearly average for 2009 was €37.2 billion).

The May-June 2010 reserve period was shaped by the implementation of the non-standard monetary policy measures decided upon by the Governing Council shortly beforehand. A six-month long-term tender was again offered as a fixed-rate tender with an indexed interest rate in mid-May. Around €36 billion was allotted in this operation. To counterbalance the liquidity inflow created by the Eurosystem's securities purchases, which were beginning under the SMP, the ECB conducted the first liquidity absorbing tender with a maturity of one week. Credit institutions showed a great willingness to release surplus liquidity for one week, especially in this first liquidity absorbing quick tender, with banks bidding a total of just under €163 billion. Ultimately the Eurosystem only distributed €16.5 billion, as this corresponded to the countervalue of the securities purchases at that time. Although this high volume of bids was not repeated in the subsequent one-week liquidity absorbing tenders of this reserve period, the Eurosystem's target volumes could still be withdrawn smoothly. During this reserve period, the level of liquidity which credit institutions had at their disposal over and above the calculated requirement was very high. As a result, the level of recourse to the deposit facility also rose markedly to €289 billion. Against this backdrop of liquidity surplus, EONIA turnover once again fell slightly compared to the previous period to €24.7 billion.

The focus of the June-July 2010 reserve period was the maturity of the first 12-month tender on 1 July. In total, €442 billion expired, around half of the outstanding refinancing volume at that time. As early as the start of March 2010, the Eurosystem had informed credit institutions that it would balance out this liquidity effect by providing an additional six-day quick tender which would bridge the gap between the one-year tender's maturity and the settlement of the next main refinancing operation. In retrospect, the maturity of this 12-month tender was well compensated for. Of particular importance in this context was firstly the regular three-month tender, which has since been reintroduced as a fixed-rate tender, whereby the credit institutions bid €132 billion and in doing so extended a part of the amount due. Secondly, the additional six-day bridging tender was well used by the institutions in the amount of €111 billion. If one also takes each previous and subsequent main refinancing operation into consideration, the outstanding refinancing volume decreased over the course of the maturity of this first one-year tender (excluding the one-week liquidity absorbing tenders and purchase programmes) by around €235 billion to €635 billion. As a result, the surplus liquidity also fell and the level of recourse to the deposit facility declined in this reserve period to an average of €230 billion. The liquidity constraints had a positive effect on EONIA turnover, which was at over €40 billion almost every day from the beginning of July, thus raising the period average to €33.6 billion. Secured overnight trading demonstrated a similar development on GC Pooling of Eurex Repo: secured overnight deposits rose to an average of €8.9 billion during this period after averaging just €5.9 billion in the April-May period and €6.7 billion in the May-June period.

Interbank trading continued its recovery during the subsequent July-August 2010 reserve period. This rise in daily EONIA turnover proves that market participants are increasing their activities in the market.

Factors determining bank liquidity[1]

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

Item	2010		
	14 Apr to 11 May	12 May to 15 Jun	16 Jun to 13 Jul
I Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors			
1 Banknotes in circulation (increase: –)	– 3.7	– 9.6	– 6.8
2 General government deposits with the Eurosystem (increase: –)	+ 1.5	– 11.0	– 3.4
3 Net foreign reserves[2]	+ 17.2	+ 5.4	+ 38.5
4 Other factors[2]	– 15.8	– 1.9	– 41.9
Total	– 0.8	– 17.1	– 13.6
II Monetary policy operations of the Eurosystem			
1 Open market operations			
(a) Main refinancing operations	– 1.0	+ 33.3	+ 57.5
(b) Longer-term refinancing operations	+ 15.9	+ 40.3	– 133.5
(c) Other operations	+ 2.8	+ 14.8	+ 33.0
2 Standing facilities			
(a) Marginal lending facility	+ 0.5	– 0.6	– 0.0
(b) Deposit facility (increase: –)	– 17.5	– 70.6	+ 58.4
Total	+ 0.7	+ 17.2	+ 15.4
III Change in credit institutions' current accounts (I + II)	– 0.1	+ 0.1	+ 1.9
IV Change in the minimum reserve requirement (increase: –)	+ 0.2	– 0.0	– 1.7

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
14.04.10	MRO (FRT)	7	70.6	212.6	1.00	100.00	–	1.00	68
14.04.10	S-LTRO (FRT)	28	15.7	–	1.00	100.00	–	1.00	12
21.04.10	MRO (FRT)	7	70.2	300.2	1.00	100.00	–	1.00	67
28.04.10	MRO (FRT)	7	75.6	332.6	1.00	100.00	–	1.00	66
29.04.10	LTRO (VRT)	91	4.8	–	1.00	100.00	1.15	1.00	24
05.05.10	MRO (FRT)	7	90.3	358.3	1.00	100.00	–	1.00	76
11.05.10	FTO (–)	1	– 319.7	–	0.80	100.00	0.76	1.00	193
12.05.10	MRO (FRT)	7	99.6	251.1	1.00	100.00	–	1.00	81
12.05.10	S-LTRO (FRT)	35	20.5	–	1.00	100.00	–	1.00	18
13.05.10	S-LTRO (FRT)	182	35.7	–	[4] ...	100.00	–	1.00	56
19.05.10	FTO (–)	7	– 16.5	–	0.29	44.39	0.28	9.86	223
19.05.10	MRO (FRT)	7	104.8	433.3	1.00	100.00	–	1.00	81
26.05.10	FTO (–)	7	– 26.5	–	0.28	73.45	0.27	3.25	93
26.05.10	MRO (FRT)	7	106.0	440.5	1.00	100.00	–	1.00	83
27.05.10	LRG (MT)	91	12.2	–	1.00	100.00	–	1.00	35
02.06.10	MRO (FRT)	7	117.7	514.7	1.00	100.00	–	1.00	86
02.06.10	FTO (–)	7	– 35.0	–	0.28	95.16	0.28	2.10	68
09.06.10	MRO (FRT)	7	122.0	439.5	1.00	100.00	–	1.00	96
09.06.10	FTO (–)	7	– 40.5	–	0.35	35.89	0.31	1.87	64
15.06.10	FTO (–)	1	– 363.5	–	0.80	100.00	0.77	1.00	174
16.06.10	FTO (–)	7	– 47.0	–	0.30	85.62	0.28	1.51	66
16.06.10	MRO (FRT)	7	126.7	296.7	1.00	100.00	–	1.00	101
16.06.10	S-LTRO (FRT)	28	31.6	–	1.00	100.00	–	1.00	23
23.06.10	MRO (FRT)	7	151.5	426.0	1.00	100.00	–	1.00	114
23.06.10	FTO (–)	7	– 51.0	–	0.40	17.07	0.31	1.40	67
30.06.10	MRO (FRT)	7	162.9	134.9	1.00	100.00	–	1.00	157
30.06.10	FTO (–)	7	– 31.9	–	1.00	100.00	0.54	1.00	45
01.07.10	LRG (MT)	91	131.9	–	1.00	100.00	–	1.00	171
01.07.10	FSO (+)	6	111.2	–	1.00	100.00	–	1.00	78
07.07.10	MRO (FRT)	7	229.1	247.6	1.00	100.00	–	1.00	151
07.07.10	FTO (–)	7	– 59.0	–	0.75	83.61	0.56	1.48	88
13.07.10	FTO (–)	1	– 200.9	–	0.80	100.00	0.76	1.00	158

* For more information on the Eurosystem's operations from 20 January 2010 to 13 April 2010, see Deutsche Bundesbank, Monthly Report, May 2010, p 34. — **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, VRT: variable-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.

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creased and in so doing approached the levels of mid-2007, albeit amid at times high volatility.

... depo-repo spread nonetheless slightly up

In the longer-term unsecured segments of the euro money market, the upward price trend has accelerated since the end of June. At present, all unsecured interbank rates with maturities of five months and above are once again above the Eurosystem's main refinancing rate. The unsecured three-month rate (3M Euribor) currently stands at 0.90% and its collateralised counterpart (3M Eurepo) at 0.50%. The risk premium, which is determined on the basis of the yield spread, is currently 40 basis points and has thus widened compared with the end of the first quarter of 2010.

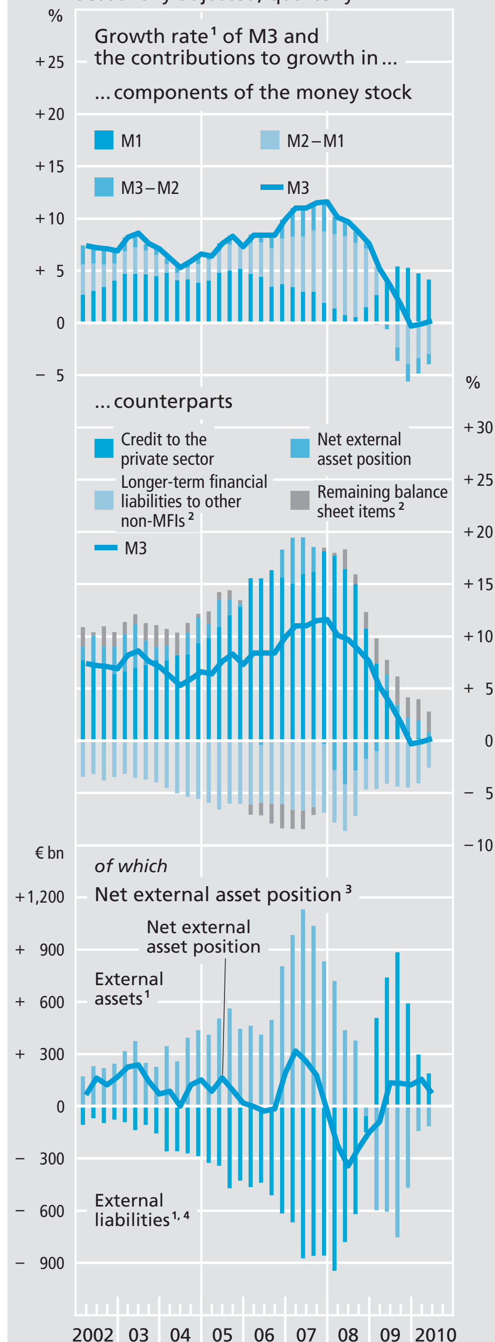
Monetary developments in the euro area

Monetary expansion accelerated

Monetary expansion in the euro area accelerated somewhat in the second quarter of 2010, although the underlying expansionary momentum remained weak. In seasonally adjusted and annualised terms, the three-month growth rate of the broad monetary aggregate M3 amounted to 3% in the April to June period and was thus perceptibly up on the preceding quarter, when growth was just over -½%. The annual growth rate of M3 likewise returned to positive territory in June, in seasonally adjusted terms, rising from an average level of -0.2% during the January to March period to 0.0% in the reporting period. Nevertheless, the current momentum should not be overstated as it is largely the result of transactions by banks with other financial intermediaries, which have been highly volatile with the tensions seen on the financial markets in the last two years.

Further increase in overnight deposits

During the second quarter, the narrow money aggregate M1 grew at a seasonally adjusted and annualised three-month rate of 7%, which was similar to the rates in the two preceding quarters. At the same time, the volume of cash in circulation increased at a corresponding rate of 5%. Overnight deposits grew at a seasonally adjusted and annualised three-month rate of just under 7½% after rising at a rate of 5½% in the previous quarter. However, this quarterly figure masks extremely heterogeneous monthly developments, as the rise in sight deposits during the second quarter was primarily the result of the activities of other financial corporations, which bolstered their stocks by an exception-



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

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ally large margin in April; in May and June, by contrast, the private sector reduced its holdings of overnight money in net terms.

Smaller net reduction in short-term deposits other than overnight deposits

The reduction in other short-term deposits, which has been observed since the beginning of 2009, continued to level off in the April to June period, while the corresponding seasonally adjusted and annualised three-month rate rose from just under -5% in the previous quarter to -3½% for the period under review. This was due, firstly, to a slower reduction in short-term time deposits (with an agreed maturity of up to two years), stocks of which declined at a seasonally adjusted and annualised three-month rate of just under -9½%, compared with -15% in the first quarter. Secondly, net demand for short-term savings deposits (with an agreed period of notice of up to three months) was down on previous quarters. Both developments were driven chiefly by households' investment behaviour. With interest rates for short-term time deposits rising again during the reporting quarter, it became less attractive to shift funds from time deposits into more liquid investments, where interest rates remained low.

Marketable financial instruments see substantial inflows

Second-quarter M3 growth was also bolstered by the momentum demonstrated by marketable financial instruments. At a seasonally adjusted and annualised three-month rate of 9%, these recorded a perceptible aggregate increase again for the first time after negative growth in the five preceding quarters. This development, however, is solely attributable to the momentum of repo transactions. The underlying highly volatile bank transactions with other financial corporations dominated this component of M3 growth in April and, particularly, in June. By contrast, money market fund shares which, in terms of volume, constitute the largest share of marketable instruments experienced strong net outflows for the third consecutive quarter. These are likely to have been triggered by the currently low short-term money market rates, which are traditionally used to determine the interest paid on money market funds. In addition, there was a discernible net reduction in the volume of short-term debt securities of monetary financial institutions (with a maturity of up to two years) held by non-banks.

Slight net increase in credit to the private sector

During the reporting quarter, credit by euro-area banks to the domestic public sector was again the main force driving monetary expansion in the euro area. In particular, net holdings of securities issued by the public sector increased at a seasonally adjusted and annualised three-month rate of 10% in the euro area, up from 7½% in the previous quarter. Likewise, credit to the domestic private sector rose; in the second quarter the corresponding growth rate increased by 1% and thus moved back into positive territory following three consecutive quarters of negative growth. This was due to bank loans, whose annualised and seasonally adjusted three-month rate was moderately up on the quarter from just under ½% to 2%; during the same period, the growth rate for annualised three-month lending to the domestic private sector, adjusted for credit institutions' securitisation activities and loan sales, rose from 0% to 2½%.

In the reporting period, the rise in loans to domestic private non-banks was again the re-

Increase in lending to households; decrease in lending to non-financial corporations

sult of heterogeneous sectoral developments. As in the two preceding quarters, loans to households rose perceptibly in net terms. This was again attributable to growth in loans for house purchase, which make up the lion's share of household borrowing. Conversely, at a seasonally adjusted and annualised growth rate of just over -1%, second-quarter lending to non-financial corporations was somewhat down, compared with a first modest upturn in the first quarter following three consecutive quarters of negative growth. Net redemptions during the reporting quarter mainly related to short-term and also, to a much lesser extent, medium-term loans to non-financial corporations (with maturities of more than one year and up to five years). By contrast, there was a further clear increase 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 a slump in economic activity than lending to households.

Marked increase in loans granted to financial corporations

In the reporting quarter, loans to the private sector in the euro area were also strengthened by loans to other financial intermediaries. Overall, these expanded significantly in the second quarter, whereas in the first quarter they had placed a perceptible damper on the growth in loans to the private sector. That said, by their very nature, the majority of such loans take the form of indirect interbank transactions, which in the past two years have been characterised by a high degree of volatility.

Purchases of private sector securities by banks continue to decline

In contrast with the situation in the traditional lending business, the reporting quarter saw a net reduction in securities claims by euro-area banks on domestic private non-banks. In the second quarter, the corresponding annualised and seasonally adjusted three-month rate went down by 4½%, following a first-quarter decrease of -2½%. During the second quarter, banks reduced their net holdings of, in particular, fixed-income securities, which had virtually stagnated in the first quarter. The volume of shares and other equity issued by the private sector and held by euro-area banks also fell, albeit much more slowly than in the first quarter.

Moderate rise in the net external asset position

In the second quarter, the net external assets of the euro-area MFI sector rose by €15.7 billion on the quarter in seasonally adjusted terms and thus, taken in isolation, had a moderately expansionary effect on monetary growth. Between April and June, without seasonal adjustment, there were substantial outflows of funds to non-euro-area countries, predominantly from Germany and Finland. At the same time, the MFI sector in Ireland, Spain and Italy recorded net inflows of funds from non-euro-area countries.

Slight decrease in monetary capital formation

After sharp increases in previous quarters, monetary capital formation declined somewhat during the reporting quarter, which, taken in isolation, tended to accelerate the pace of monetary growth. Overall, MFI longer-term financial liabilities fell by just over ½% in seasonally adjusted and annualised terms in the second quarter of 2010, after having risen by 5% in the previous quarter. This development was largely driven by an

exceptionally sharp reduction in non-banks' holdings of bank debt securities with longer maturities, which – in quantitative terms – represent the largest component of monetary capital. First, this was due to the reduced issuance of bank debt securities in several euro-area countries. Second, euro-area banks increased their purchases of debt securities issued by other institutions on the market, which further reduced the stock of such paper held by the non-bank sector. Moreover, the smaller inflows – compared with previous quarters – to long-term time and savings deposits, in particular from households as well as from insurers and pension funds had a moderately negative net impact on monetary capital during the second quarter. This reflects the narrower interest rate differential between short and long-term deposits in the euro area during the reporting quarter. By contrast, during the same three-month period, banks again raised their capital and reserves on a large scale.

No pronounced risk to price stability from a monetary perspective

Overall, the underlying monetary dynamics – in other words, monetary growth which is ultimately relevant to inflation – remained weak in the reporting quarter. Although the M3 monetary aggregate posted its first perceptible gain again in the second quarter, this growth was largely attributable to the financial corporations sector and is related to the tensions that are still evident in several segments of the financial market. At the same time, overall bank lending to the private sector in the euro area remained moderate during the second quarter. That monetary expansion accelerated in the reporting quarter was also reflected in inflation projections based on monetary data. The projected inflation rates have risen slightly further compared to the first quarter of 2010. Taken as a whole, these projections nonetheless continue to indicate that there is no pronounced risk to price stability in the euro area over the next three years.

German banks' deposit and lending business with domestic customers

Rise in domestic investors' bank balances ...

In the second quarter of 2010, growth in German investors' deposits with domestic banks accelerated, which was solely attributable to the way in which short-term bank balances developed. Overall, the seasonally adjusted and annualised three-month rate for all deposits went up from 1½% in the first quarter of 2010 to just over 3% in the reporting quarter.

... due to inflows to short-term investments

At a seasonally adjusted and annualised three-month rate of 20½%, growth in overnight deposits in the second quarter returned to the high rates recorded the previous year, having risen just 7% in the first quarter. The (negative) momentum shown by short-term time deposits (with an agreed maturity of up to two years) likewise gathered pace in the second quarter as the interest rate differential between these funds and overnight deposits narrowed slightly in Germany. In terms of volumes, however, outflows from short-term time deposits during the reporting quarter were well below the inflows recorded for sight deposits. In the second quarter, the former recorded a seasonally adjusted and annualised three-month rate of just under -30%,

compared with just under -18% in the previous quarter, and thus lagged far behind the exceptionally high reduction rates posted in the year before. Short-term savings deposits (with an agreed maturity of up to three months) merely posted a renewed slowdown in growth. The seasonally adjusted and annualised three-month rate was slightly more than 6%, compared with just over 9% in the first quarter. As in the rest of the euro area, developments in short-term deposits during the period under review were determined not just by the behaviour of households but also, to a considerable extent, by that of financial corporations.

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

€ billion, seasonally adjusted

Item	2010	
	Q1	Q2
Deposits of domestic non-MFIs 1		
Overnight	16.9	48.6
With agreed maturities		
of up to 2 years	– 16.5	– 27.8
of over 2 years	1.3	– 3.3
Redeemable at notice		
of up to 3 months	10.6	7.3
of over 3 months	– 1.5	– 3.1
Lending		
to domestic enterprises and households		
Loans	– 27.6	20.8
of which: to households 2	2.3	2.9
to non-financial corporations 3	– 0.2	0.1
Securities	– 14.0	5.4
to domestic general government		
Loans	3.3	13.4
Securities	5.5	22.5

* As well as banks (including building and loan associations, but excluding the Bundesbank), monetary financial institutions (MFIs) here also include money market funds. — 1 Enterprises, households and general government excluding central government — 2 And non-profit institutions. — 3 Including non-financial quasi-corporations.

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Long-term deposit types less attractive

Long-term types of deposit, stocks of which virtually stagnated in the first quarter, were reduced substantially in net terms during the second quarter. In terms of volumes, long-term savings deposits and the quantitatively more significant long-term time deposits were equally affected. In seasonally adjusted and annualised terms, stocks of the former declined by just over 10% in the reporting quarter. During the same three months, long-term time deposits fell at a corresponding three-month rate of -1½%, one contributory factor being the persistently sharp reductions in these balances by insurance corporations and pension funds. Another important factor was that – as elsewhere in the euro area – households' strong demand for long-term time deposits, which has been observed since the final quarter of 2009, eased off when compared with the two preceding quarters.

Strong credit provision by German banks to the private sector

During the reporting quarter, overall seasonally adjusted credit provision by domestic credit institutions to the domestic private sector expanded more than at any other time over the past four quarters. The seasonally adjusted and annualised three-month rate of change for total credit increased from -6% in the first quarter to 4% in the reporting quarter. During this period, there was a discernible increase in securitised net lending to the private sector, which rose by a seasonally adjusted and annualised 7%, after having decreased by -15½% in the previous quarter. Loan volumes to the domestic private sector were up by a more significant amount in the second quarter of 2010, after declining perceptibly for three consecutive quarters. In the second quarter, the corresponding annualised and seasonally adjusted three-month rate stood at 3½%, compared with -4½% in the previous quarter. It must be noted, however,

that since the first quarter of 2009 this development has largely been determined by the dynamics of lending to financial corporations and that these dynamics were highly volatile on account of the turmoil in the financial markets.

Clear increase in loans to households

Expanded lending to financial corporations during the reporting quarter was accompanied by a substantial seasonally adjusted increase in the volume of loans granted to households. In annualised terms, the corresponding three-month rate stood at just under 1% in the second quarter, up from ½% in the previous quarter. As in the first quarter of 2010, loans for house purchase virtually stagnated; growth was therefore largely attributable to other forms of credit.

Lending to non-financial corporations stagnated

After steep declines in net lending by German banks to non-financial corporations for three consecutive quarters in 2009, lending activity to this sector stagnated in the first two quarters of 2010. The corresponding annualised and seasonally adjusted three-month rate for both quarters stood at 0%. Flows were positive and negative in turn in the individual months of the first half of the year. Hence, looking at monthly changes, the downward trend in lending momentum appears to have been broken, although the turning point cannot yet be identified. As far as the maturity structure is concerned, short-term lending to non-financial corporations continued to decline during the reporting quarter, albeit at a slower pace, while medium-term loans were reduced for the second quarter in a row. In the course of the second quarter, long-term loans alone experienced a mild acceleration in their – broadly moderate – expansionary course. Overall, the real economy still provides a good explanation for developments in loans to non-financial corporations in the second quarter of 2010. The banking statistics therefore provide no indication of a credit crunch in Germany.

Increased credit to general government

In the second quarter, German banks once again on balance channelled more funds to domestic general government than to the domestic private sector. In seasonally adjusted and annualised terms, credit provision to the public sector rose by 31½%, as opposed to more than 7% in the first quarter. This accelerated expansion in lending applied to both standard loans and securitised lending. However, this pronounced increase is largely a reflection of transactions made with a bad

Third special survey on German banks' lending to domestic enterprises

In July 2010 the Deutsche Bundesbank repeated its special survey among selected German banks and banking associations, which it had conducted in July 2009 and at the turn of 2009-10.[1] The aim of this survey is to gauge how banks expect their lending business with domestic non-financial corporations to develop over the next twelve months. The participating institutions were also asked *inter alia* to forecast the development of their capital position.

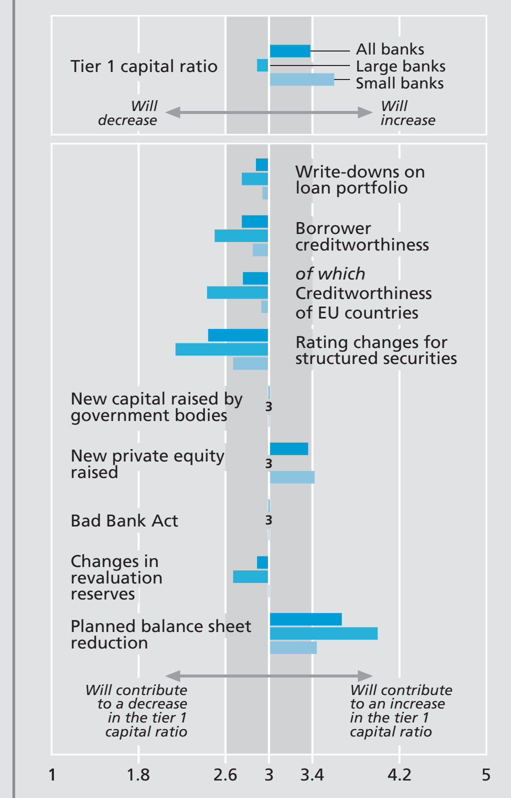
The current survey provided no indications of an imminent credit crunch. Fears of the German economy being undersupplied with credit as the upswing gathers steam are therefore not shared by the surveyed banks.

Overall, survey participants expect the volume of lending to rise over the next twelve months, driven mainly by loans to small and medium-sized enterprises. An optimistic assessment of new lending is accompanied by the expectation of high repayments on existing loans, especially by large enterprises. In contrast to past survey rounds, write-downs on the loan portfolio do not seem to be affecting the volume of lending over the forecasting horizon. On balance, the small banks surveyed expressed a somewhat more positive view of developments in their lending volume than the large institutions.

The forecast increase in lending volume is attributed to an improvement in the outlook for general economic activity and rising demand. This assessment is also demonstrated by the expectation of increasing drawdowns on existing credit lines and of a larger overall volume of credit applications. In response, the surveyed banks are planning to expand the credit lines granted, while leaving the rejection ratio unchanged. Overall, they do not expect dampening factors to influence lending to domestic enterprises over the next twelve months.

According to the results of the current survey, the tier 1 capital ratio is anticipated to remain unchanged on average over the next twelve months, although the large banks surveyed were slightly more pessimistic on balance than the small banks that even expect a small rise in this ratio. As banks see it, the chief factors weighing on the tier 1 capital ratio in the next twelve months are likely to be changes in the ratings of structured securities and poorer borrower creditworthiness. All other things being equal, the surveyed institutions expect that planned balance sheet reductions and profit retention will improve their tier 1 capital ratio, however. The participating banks do not expect government measures to provide any relief.

Forecast of the tier 1 capital ratio for the next 12 months and key determinants[2]



1 See the detailed report on our website www.bundesbank.de/volkswirtschaft/vo_veroeffentlichungen.en.php. — 2 For this question, the possible responses range from "1 = will decrease considerably/will contribute considerably to a decrease of the tier 1 capital ratio" to "5 = will increase considerably /will contribute considerably to an increase of the tier 1 capital ratio". When this range is broken down into five intervals of equal width, there is an area of uncertainty between 2.6 and 3.4 (shaded in grey), which is interpreted as "will remain basically unchanged/will have basically no impact on the tier 1 capital ratio". — 3 At least 90% of the banks surveyed gave the response "not applicable" or "not stated" to this question.

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bank under German federal law that was established on the basis of the Financial Market Stabilisation Development Act *(Gesetz zur Fortentwicklung der Finanzmarktstabilisierung)* and which falls under the general government sector.

Credit supply conditions virtually unchanged ...

The results of the latest Bank Lending Survey (BLS), which was conducted in July 2010, indicate broadly unchanged credit supply conditions in Germany during the second quarter of 2010. For instance, on balance, credit standards in corporate lending remained constant while, for the first time since the second quarter of 2007, the general outlook for economic activity, viewed in isolation, again had a positive effect, as did the continued strong liquidity situation of the surveyed institutions. By contrast, banks' capital costs had no effect on credit standards in the second quarter of 2010. According to the special Bundesbank survey which was carried out at the same time as the BLS, these bank-specific factors are also unlikely to have much impact on expected loan developments over the next 12 months.[1]

Furthermore, according to the BLS data, margins were not made any more restrictive during the second quarter of 2010, and those for average-risk loans to large enterprises were even tightened slightly again. While the findings of the survey for the first quarter of 2010 were broadly consistent for Germany and the euro area, developments at the current end diverge slightly, as credit standards and margins in the euro area both rose somewhat during the second quarter of 2010. Moreover, on balance, banks taking part in the euro-area sample reported no change in demand for loans to enterprises, whereas German institutions recorded a marked increase in demand for funds in this credit segment. According to the information provided by the banks, this was, in Germany, in large part due to a sharp increase in financing needs for inventories and working capital.

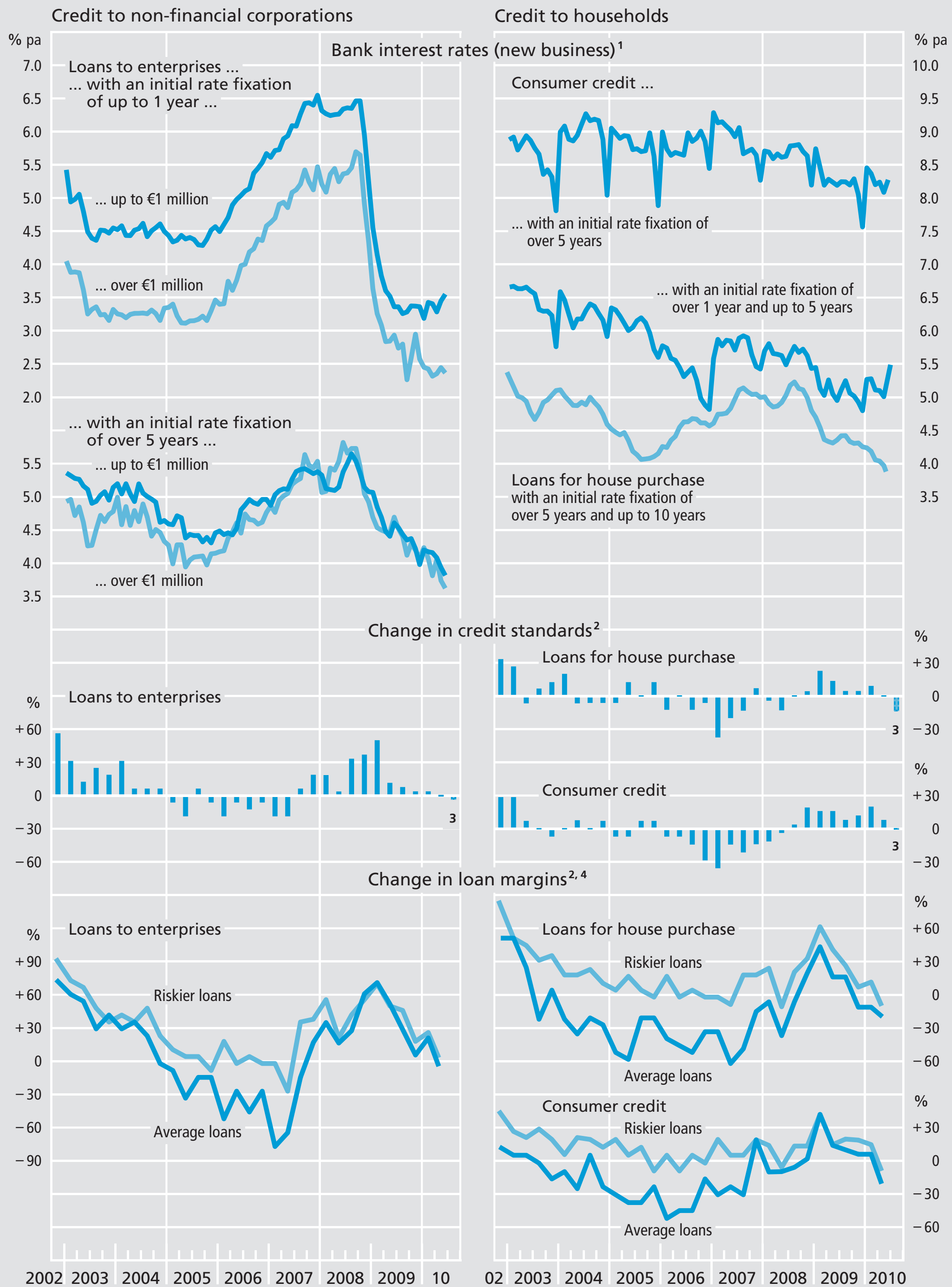
Credit standards for lending to households likewise remained broadly unchanged in the second quarter of 2010. The surveyed banks only effected a moderate tightening of standards for lending for consumption purposes. In contrast to the action taken regarding credit standards, margins for both house purchase and consumer credit were tightened for the first time since the second quarter of 2008. At the same time, the surveyed banks observed a sharp rise in demand from households for loans for house purchase, which they attributed to increased risk aversion and low interest rates, among other factors. Demand for consumer loans rose somewhat less strongly.

... and somewhat more difficult access to wholesale funding

The survey round for the second 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 institutions, access to wholesale funding on the money and capital markets was somewhat more difficult than in the previous quarter. At the same time, just over one-third of German bank managers said capital costs were higher in the wake of the

1 See box on p 35: Third special survey on German banks' lending to domestic enterprises.

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 Q3. — **4** Reduced scale.

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financial crisis, slightly fewer than in the previous quarter. This resulted in some lending constraints at a number of the affected institutions.

Bank lending rates mostly declining

Bank lending rates on new loans likely supported domestic lending to the private sector. Reflecting developments on the capital market, reporting institutions experienced declining lending rates across the board in the second quarter of 2010. Consequently, the rate of interest charged on long-term loans to non-financial corporations fell to 3.8% for small-scale loans and 3.6% on larger-scale loans as this report went to press. Conversely, in some cases, German banks charged slightly higher interest rates for corporate loans with short interest-rate fixation. Lastly, the cost of bank loans for house purchase was down on the quarter, with long-term interest rates dropping below the 4% mark for the first time since these statistics have been kept.