Monetary policy and banking business

Interest rate policy and the money market

Key Eurosystem rates unchanged

The cyclical recovery in the euro area continued in the third quarter of 2010. As expected, the rate of expansion was down compared with the extremely dynamic growth seen in the previous quarter. Nonetheless, the upswing remains uninterrupted. Economic activity in the euro area benefited from ongoing positive developments at the global level along with the exceptionally robust dynamics underpinning the German economy. For the next few months, the Governing Council of the ECB expects this recovery to continue. Against this backdrop, and taking into account the solidly anchored longer-term inflation expectations as well as the still weak, though recently accelerating, underlying pace of monetary expansion, the Council sees no increased risks to price stability over the time horizon relevant to monetary policy. For this reason, the Council again chose to leave the Eurosystem's key policy rates unchanged in the third quarter of 2010. The interest rate at which the Eurosystem supplies its counterparties with central bank liquidity as part of main refinancing operations (MROs), which were once again conducted as fixed-rate tenders with full allotment between July and September, thus remains at 1%; the interest rate on the marginal lending facility is 1.75%. Funds held under the deposit facility are remunerated at 0.25%.

Full allotment for MROs to be continued until the beginning of 2011

In order not to jeopardise the nascent recovery on the euro money market by exiting the non-standard monetary policy measures too quickly, the ECB Governing Council

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
14.07.10	FTO (–)	7	– 60.0	–	0.65	71.46	0.56	1.64	85
14.07.10	MRO (FRT)	7	195.7	61.2	1.00	100.00	–	1.00	147
14.07.10	S-LTRO (FRT)	28	49.4	–	1.00	100.00	–	1.00	34
21.07.10	MRO (FRT)	7	201.3	153.3	1.00	100.00	–	1.00	163
21.07.10	FTO (–)	7	– 60.0	–	0.64	8.84	0.56	1.62	88
28.07.10	FTO (–)	7	– 60.5	–	0.60	24.04	0.55	1.46	86
28.07.10	MRO (FRT)	7	190.0	186.0	1.00	100.00	–	1.00	151
29.07.10	LTRO (FRT)	91	23.2	–	1.00	100.00	–	1.00	70
04.08.10	FTO (–)	7	– 60.5	–	0.50	86.22	0.45	1.91	93
04.08.10	MRO (FRT)	7	154.8	190.3	1.00	100.00	–	1.00	125
10.08.10	FTO (–)	1	– 201.8	–	0.80	100.00	0.77	1.00	171
11.08.10	MRO (FRT)	7	153.7	59.7	1.00	100.00	–	1.00	111
11.08.10	S-LTRO (FRT)	28	39.1	–	1.00	100.00	–	1.00	36
11.08.10	FTO (–)	7	– 60.5	–	0.47	28.94	0.43	2.04	94
18.08.10	MRO (FRT)	7	155.2	148.2	1.00	100.00	–	1.00	109
18.08.10	FTO (–)	7	– 60.5	–	0.40	70.45	0.39	2.13	89
25.08.10	MRO (FRT)	7	150.3	139.3	1.00	100.00	–	1.00	112
25.08.10	FTO (–)	7	– 60.5	–	0.37	45.53	0.35	1.79	82
26.08.10	LTRO (FRT)	91	19.1	–	1.00	100.00	–	1.00	49
01.09.10	MRO (FRT)	7	153.1	139.1	1.00	100.00	–	1.00	111
01.09.10	FTO (–)	7	– 61.0	–	0.35	18.62	0.33	1.92	71
07.09.10	FTO (–)	1	– 175.4	–	0.80	100.00	0.77	1.00	168
08.09.10	MRO (FRT)	7	153.7	50.2	1.00	100.00	–	1.00	111
08.09.10	S-LTRO (FRT)	35	37.9	–	1.00	100.00	–	1.00	27
08.09.10	FTO (–)	7	– 61.0	–	0.39	1.65	0.33	1.71	64
15.09.10	MRO (FRT)	7	151.6	159.1	1.00	100.00	–	1.00	105
15.09.10	FTO (–)	7	– 61.0	–	0.37	23.02	0.34	1.62	60
22.09.10	MRO (FRT)	7	153.8	188.8	1.00	100.00	–	1.00	109
22.09.10	FTO (–)	7	– 61.5	–	0.36	44.21	0.34	1.47	59
29.09.10	MRO (FRT)	7	166.4	33.4	1.00	100.00	–	1.00	129
29.09.10	FTO (–)	7	– 61.5	–	0.75	22.14	0.38	1.47	44
30.09.10	LTRO (FRT)	84	104.0	–	1.00	100.00	–	1.00	182
30.09.10	FTO (+)	6	29.4	–	1.00	100.00	–	1.00	50
06.10.10	MRO (FRT)	7	197.0	115.5	1.00	100.00	–	1.00	148
06.10.10	FTO (–)	7	– 63.5	–	0.50	83.83	0.42	1.80	77
12.10.10	FTO (–)	1	– 109.0	–	0.80	100.00	0.76	1.02	143

***** For more information on the Eurosystem's operations from 14 April 2010 to 13 July 2010, see Deutsche Bundesbank, Monthly Report, August 2010, p 28. — **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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announced in September that it would continue to conduct all MROs as well as refinancing operations with a maturity of one maintenance period as fixed-rate tender procedures with full allotment at the main refinancing rate for as long as needed, and at least until 18 January 2011. At the same time, the Council resolved to continue with full allotment for three-month longer-term refinancing operations (LTROs) beyond the turn of the year, but to conduct the fourth-quarter tenders on an interest-indexed basis. The decision not to return to variable-rate tenders for the duration of 2010 was based, first, on past experience which has shown that banks' end-of-year liquidity needs are hard to predict and, second, the consideration that the exit from non-standard monetary policy measures would in any event carry on automatically in the fourth quarter

Money market management and liquidity needs

During the three reserve maintenance periods between 14 July and 12 October 2010, euro-area credit institutions' need for central bank liquidity as determined by autonomous liquidity factors fell significantly by €42.7 billion in net terms. Seasonal factors meant that banknote circulation increased considerably in the reserve period from July to August and reached a new peak of €823 billion on 6 August 2010. During the period under review as a whole, however, banknotes only absorbed liquidity of €1.1 billion due to weaker demand for banknotes in subsequent periods. General government deposits with the Eurosystem decreased considerably by €30.1 billion and thereby had a liquidity-providing effect. Although deposits have thus contracted from the high volume seen during the financial crisis, they still remain above pre-crisis levels. If net foreign reserves and other factors are taken together, a move which eliminates liquidity-neutral valuation effects, banks' liquidity needs likewise fell by €13.7 billion over the three periods. The liquidity needs arising from the minimum reserve requirement declined by €1.1 billion over the three reserve maintenance periods and were met by credit institutions without any problems.

Eurosystem liquidity management continues to focus above all on supporting the money market by means of a generous supply of liquidity. Refinancing operations were still conducted as fixed-rate tenders with full allotment (see table on page 25).

With the second one-year tender expiring, liquidity above the benchmark dropped significantly, which led to a revival of the interbank market with increasing money market rates and turnover.

The purchases made as part of the Securities Markets Programme, which was launched in May 2010, took place on a low level during the period under review. With the introduced weekly liquidity-absorbing fine-tuning operations, the liquidity effect of the programme was still neutralised smoothly. Demand for the US dollar liquidity-providing operations, likewise agreed upon in May, was extremely low.

At the beginning of the reserve period from July to August, the reduced liquidity supply due to the first one-year tender expiring at the start of July caused the EONIA to rise to 0.56%. As a result of the reduced liquidity, EONIA turnover increased from a daily average of €34 billion in the previous period to €58 billion. As is often the case when there is liquidity in abundance, more credit institutions met their reserve requirements at the beginning of the period, resulting in decreasing demand for liquidity over the period and the EONIA falling back to a lower level. The last day of the reserve period was the exception when the Eurosystem carried out a €262 billion liquidity-absorbing fine-tuning operation and the EONIA was fixed at 0.77%. With overnight rates lower, turnover also fell. However, at €47 billion on average, turnover was significantly higher than in the previous periods and bore testimony to a rise in activity on the unsecured overnight money market. Reduced excess liquidity was also reflected in the recourse made to the deposit facility, which was a lot lower this period, with an average of €97 billion, than in the previous period (€230 billion).

In the August-September reserve period, the EONIA fluctuated within a range of 0.36% to 0.48%. At an average of 0.43%, it was 4 basis points lower than in the previous period and was more in line with the deposit facility rate of 0.25% despite reduced liquidity. As seen in the previous periods, the end of the month was not marked by a pronounced rise in overnight rates. Only at the end of the reserve period on 7 September 2010 did the combined effect of more restricted interbank trading, which is always observed on the last day of the period, and the liquidity-absorbing quick tender with a volume of €236 billion result in the EONIA climbing to 0.70%. Average turnover was not quite at the previous peri-

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od's level but – at €44 billion – was still significantly higher than before the expiry of the first one-year tender. Compared with the previous period, use of the deposit facility, at an average of €84 billion per day, fell again.

The most important event of the maintenance period from September to October was the second one-year tender expiring. Parallel to this, one six-month and one three-month tender expired with the result that refinancing operations with a total volume of €225 billion matured on 30 September. In order to make the transition as smooth as possible, the Eurosystem offered an additional six-day quick tender on top of the regular three-month operation to bridge the period until the next main refinancing operation. The combined demand for these two tenders stood at €133 billion, markedly reducing the total volume of outstanding refinancing operations – by €80 billion to €512 billion. With market participants expecting higher prolongation, the lower volume was seen as a signal that the interbank market had recovered further. The decline in liquidity was also reflected in higher overnight rates. On 30 September, the EONIA climbed by 47 basis points to 0.88%. One decisive reason for this sharp rise is likely to have been the end of the quarter, when banks regularly considerably scale back lending. Overnight rates fell only slowly in the subsequent days, however. Owing to the Eurosystem's usual liquidity-absorbing fine-tuning operation worth €172 billion on the last day of the maintenance period, they rose to 0.76%. The EONIA thereby exceeded the levels of previous periods by an average of 0.48 percentage point. Compared to the previous period, turnover increased, too, and attained an average value of €47 billion (previous period: €44 billion). Furthermore, the drop in excess liquidity dampened the usual increase in the deposit facility towards the end of the reserve period, causing the average daily use of the deposit facility to fall to €69 billion.

Factors determining bank liquidity[1]

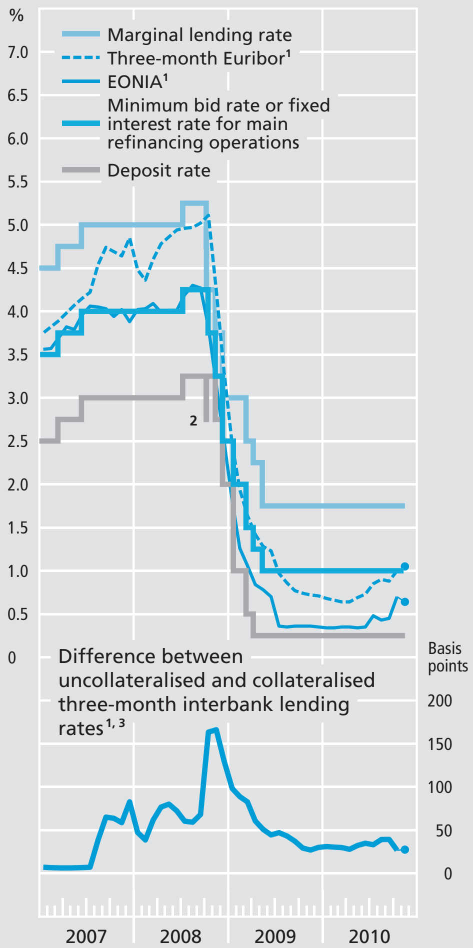
€ billion; changes in the daily averages of the reserve maintenance periods vis-à-vis the previous period

Item	2010 14 July to 10 Aug	11 Aug to 7 Sep	8 Sep to 12 Oct
I Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors			
1 Banknotes in circulation (increase: –)	– 6.3	+ 3.3	+ 1.9
2 General government deposits with the Eurosystem (increase: –)	+ 31.3	+ 8.4	– 9.6
3 Net foreign reserves[2]	+ 42.5	– 0.2	– 11.9
4 Other factors[2]	– 44.7	+ 3.2	+ 24.8
Total	+ 22.8	+ 14.7	+ 5.2
II Monetary policy operations of the Eurosystem			
1 Open market operations			
(a) Main refinancing operations	+ 17.9	– 32.3	+ 11.4
(b) Longer-term refinancing operations	– 141.0	+ 2.8	– 42.4
(c) Other operations	– 31.9	+ 1.0	+ 8.6
2 Standing facilities			
(a) Marginal lending facility	– 0.2	+ 0.5	+ 0.1
(b) Deposit facility (increase: –)	+ 133.7	+ 13.0	+ 14.9
Total	– 21.5	– 15.0	– 7.4
III Change in credit institutions' current accounts (I + II)	+ 1.3	– 0.4	– 2.2
IV Change in the minimum reserve requirement (increase: –)	– 1.3	+ 0.5	+ 1.9

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.

In the subsequent reserve period from October to November, the EONIA initially continued to rise albeit with lower excess liquidity. Turnover also remained at a high level. Secured overnight money trading also saw a rise in interest rates and in turnover. All this is evidence that the interbank market is progressively improving, even though the Eurosystem's intermediary function continues to be pronounced and necessary for some banks.

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 15 November 2010.

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upon maturity of the third and final one-year tender as well as of the final six-month LTRO. Finally, to ensure the continued supply of liquidity to the banking system, the Council announced additional fine-tuning operations (FTOs) for when these two transactions mature, namely on 11 November and 23 December 2010.

Frontloading reduced, excess liquidity lowered, money market rates up

When the first two one-year tenders and the penultimate six-month tender matured in the second and third quarters of 2010, the volume of refinancing operations, taken in isolation, was already down by over €535 billion. Banks offset this withdrawal of liquidity only partially by increasing their bidding volumes in other regular operations, which, in aggregate terms, markedly lowered excess liquidity in the banking system. This led to a trend rise in money market interest rates, which was also attributable to growing optimism among money market participants, especially in the third quarter of 2010, after a run of surprisingly upbeat macroeconomic data. Of late, there has been a discernible decline in euro-area banks' frontloading of reserves as a means of fulfilling their minimum reserve requirements. Instead, they further reduced excess liquidity in the banking system, especially at the beginning of the tenth maintenance period in October. As a result, amid strong fluctuations, the overnight money market rate EONIA likewise rose perceptibly, and, subject to similarly high volatility, the underlying turnover stabilised at an elevated level compared with during the crisis. The EONIA currently stands at around 0.8% and is thus well above the level recorded for the first half of 2010.

Longer-term money market rates showing slight upwards trend at last count

The longer-term money market rates mimicked the overnight money market rate and also increased significantly at the end of October. The unsecured three-month rate (3M Euribor) climbed to 1.05% at last count and is thus almost 0.3 percentage point above its level at the end of the second quarter. During the same period, its collateralised counterpart (3M Eurepo) rose by around 0.3 percentage point to roughly 0.75% as this report went to press. The spread between both interest rates, which can be interpreted as a risk premium, stood at around 0.25 percentage point at the end of October, not far off its lowest level since the financial market turmoil began in August 2007. Since then it has risen slightly again to currently around 0.3 percentage point.

Monetary developments in the euro area

Monetary expansion still muted in 2010 Q3

In the third quarter of 2010, monetary expansion in the euro area remained muted in overall terms, but continued to accelerate. In seasonally adjusted and annualised terms, the three-month growth rate of the broad monetary aggregate M3 amounted to just over 3½% in the July to September period and was therefore again perceptibly up on the preceding quarter, when growth was 3%. The annual growth rate of M3 thus moved into positive territory in seasonally adjusted terms, with the average figure going up from 0.0% between April and June to 0.8% for the months July to September 2010. In this context, however, it should be borne in mind that, as in the previous quarter, the current momentum is largely the result of transactions of banks with other financial intermediaries, which have proved very volatile in the wake of the financial market tensions of the last two years and often reflect indirect interbank transactions.

Slower growth in overnight deposits, greater momentum in other short-term deposits

Between July and September, growth of the seasonally adjusted and annualised three-month rate for the narrow monetary aggregate M1, which had started at the end of 2009, continued to decelerate. First, growth in currency in circulation declined slightly in the third quarter. Second, and more significantly in terms of volume, it was once again the case that fewer overnight deposits were made than in the previous quarter, particularly on the part of households. By contrast, during the same period, the positive growth experienced by other short-term deposits accelerated, with the corresponding seasonally adjusted and annualised three-month rate turning positive again in the third quarter of 2010 for the first time since the end of 2008. This was principally due to a renewed increase in inflows to short-term savings deposits (redeemable at notice of up to three months). In addition, over the same three-month period, short-term time deposits (with an agreed maturity of up to two years) were bolstered, after recording extensive net outflows in the preceding one-and-a-half years as funds were shifted into other types of assets. Recent developments are likely to have been further aided by the fact that the interest rates available on short-term time deposits continued to go up compared with sight deposits in the reporting quarter.

Marketable financial instruments see small outflows

Conversely, in the third quarter of 2010, developments in marketable instruments held by non-banks had a moderately dampening effect on M3 growth. Following still perceptible M3 growth in the second quarter, the fall in the seasonally adjusted and annualised three-month rate seen in the reporting quarter was again closer to the pattern of the previous few quarters. This was mostly due to renewed outflows from money market funds, which account for the largest volume share of marketable instruments. However, this decline is now considerably less marked due to the gradually increasing, albeit still low, short-term money market rates, which are traditionally used to determine the interest paid on money market funds. Repo transactions and short-term debt securities of monetary financial institutions held by non-banks virtually stagnated in the reporting quarter.

Loans to the private sector drive monetary expansion

For the first time since the end of 2008, credit by euro-area banks to the domestic private sector was again the driving force behind monetary expansion in the euro area during the reporting quarter. Having returned to positive territory in the second quarter of 2010 at 1% growth after three successive quarters of negative readings, the annualised and seasonally adjusted three-month rate picked up pace again in the third quarter to stand at just over 3½%. This expansion was fairly evenly split between standard loans and securitised lending. With respect to bank loans, the three-month rate fell moderately on the quarter from 2½% to 2%, in seasonally adjusted and annualised terms; during the same period, the annualised three-month rate, adjusted for credit institutions' securitisation activities and loan sales, rose from 2½% to 3%.

Increased lending to households, non-financial corporations ...

For the first time in two years, the rise in loans to domestic private non-banks was once again borne by all three sectors, with loans to households increasing the most. For the sixth successive quarter, expansion in this category was driven by loans for house purchase, which make up the lion's share of household borrowing, although their increases have become slightly less pronounced in the past few months. Between July and September, loans to non-financial corporations likewise posted a modest net increase, with a seasonally adjusted and annualised three-month rate of just over 1½% following a marginal decline of just under -½% in the preceding three-month period. During the reporting quarter, net lending to non-financial corporations was more or less evenly split between long-term loans (with a maturity of over five years) and short-term loans (with a maturity of up to one year), which thus went up perceptibly again for the first time in almost two years. Conversely, medium-term loans to enterprises stagnated. Overall, it is broadly consistent with the pattern that is familiar from earlier periods of economic recovery, that unsecuritised lending to non-financial corporations recovers more slowly from a slump in economic activity than lending to households.

... and financial corporations

As in the previous quarter, loans to the private sector in the euro area in the July to September period were strengthened by loans to other financial intermediaries. However, some of these loans are, by nature, indirect interbank transactions which in the past two years have been characterised by a high degree of volatility and, in the traditional sense, have no impact on lending to the private non-banking sector.

As in the traditional lending business, there was a marked increase in securities claims by

Discernible increase in purchases of private sector securities

euro-area banks on domestic private non-banks in the reporting quarter. The corresponding annualised and seasonally adjusted three-month rate went up by 12% between July and September, following a second-quarter decrease of 8%. In the same period, euro-area banks raised their net holdings of, in particular, fixed-income securities and also perceptibly upped their holdings of shares and other equity issued by the private sector. Overall, euro-area banks also clearly increased their net holdings of securities issued by the public sector, at a seasonally adjusted and annualised three-month rate of 7½%.

Moderate decline in the net external asset position

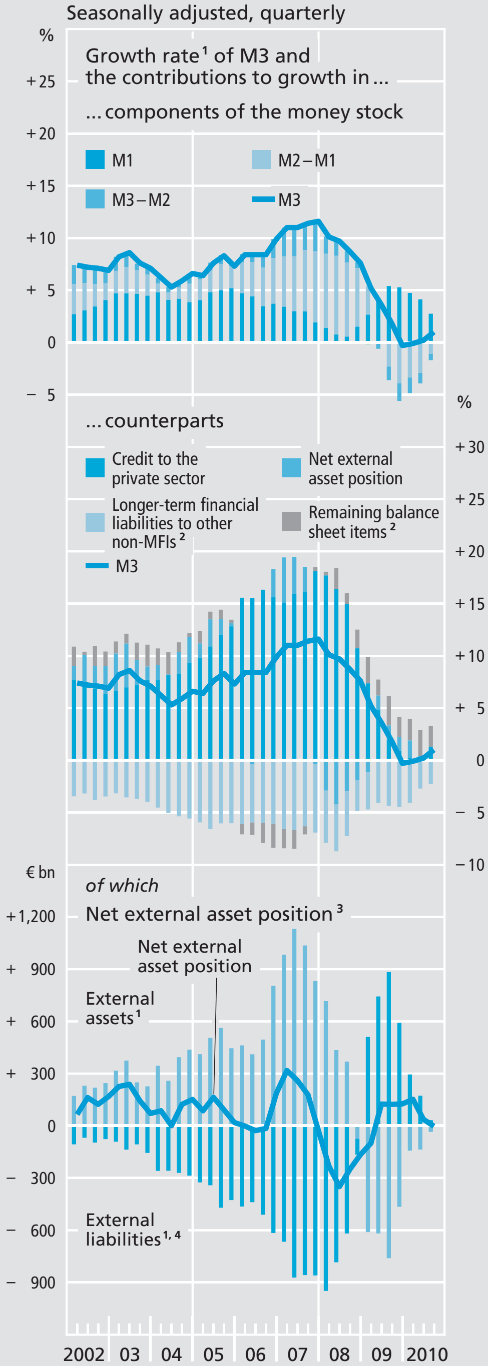
In the third quarter, the net external asset position of the euro-area MFI sector fell by €18.7 billion on the quarter in seasonally adjusted terms and thus, taken in isolation, had a moderately restrictive effect on monetary growth. There were substantial outflows of funds to non-euro-area countries in the reporting quarter, predominantly from Germany and Spain. At the same time, the MFI sector in Finland, the Netherlands and Luxembourg, in particular, recorded net inflows of funds from countries outside the euro area. These data are, however, not seasonally adjusted.

Buoyant monetary capital formation

Following a period of stagnation between April and June, monetary capital formation returned to the positive growth path it had followed in preceding quarters which, *per se*, tended to slow the pace of monetary growth. All in all, banks' longer-term financial liabilities vis-à-vis non-banks rose by just under 4½% in seasonally adjusted and annualised terms in the third quarter of 2010. This development was driven, first, by a noticeable in-

Components and counterparts of the money stock in the euro area

Seasonally adjusted, quarterly



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

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crease in non-banks' holdings of bank debt securities with longer maturities. Second, the private sector built up its holdings of long-term time deposits, although their attractiveness to households as well as insurers and pension funds had waned on the back of a further narrowing of the interest rate spread between short and long-term deposits in the euro area during the reporting quarter. The other components had practically no impact on monetary capital in the same period. While banks had raised their capital and reserves considerably in the second quarter of 2010, these stagnated between July and September. As in the previous quarter, households especially reduced their holdings of long-term savings deposits by a substantial margin.

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 muted in the reporting quarter. Although the monetary aggregate M3 increased appreciably between July and September for the second quarter in a row, this growth was in turn largely attributable to transactions with other financial intermediaries. Given that some of these take the form of collateralised transactions which are settled via trading platforms, the aforementioned growth is also related to the tensions that are still evident in several segments of the financial market. At the same time, bank lending to the private sector in the euro area continued to expand moderately overall in the third quarter of 2010. In line with this, aggregate inflation projections based on monetary data (albeit surrounded by particularly great uncertainty due to the crisis) continue to indicate that there is no pronounced risk to price stability in the euro area over the time horizon relevant to monetary policy.

German banks' deposit and lending business with domestic customers

Rise in domestic investors' bank balances ...

Between July and September 2010, domestic investors continued to make appreciable deposits with German banks. As in the previous quarter, however, this was solely attributable to the way in which short-term bank balances developed; in net terms, long-term balances contracted perceptibly. Overall, at just under 3%, the third-quarter seasonally adjusted and annualised three-month rate for all deposits was slightly down on the quarter.

... due to inflows to short-term segment

Overnight deposits continued to have a favourable influence on this growth rate, although their seasonally adjusted growth rate weakened substantially, not least owing to noticeably reduced interest on the part of households. Demand for short-term time deposits, which had dropped sharply over the past few quarters, stagnated in the reporting quarter. On the heels of a somewhat more subdued second quarter, the uptake of short-term savings deposits (redeemable at notice of up to three months) accelerated again in the third quarter of 2010 and thus reverted to the positive growth pattern seen in preceding quarters.

During the third quarter, long-term deposits were sharply reduced in seasonally adjusted terms, on balance, though to a lesser extent

By contrast, marked reduction in long-term deposit types

than in the second quarter. This was solely due to households' large-scale withdrawal from long-term savings deposits, which can probably be explained by the ongoing relative deterioration of the interest rates available on such deposits. By contrast, during the same period, there was a modest increase in the quantitatively more significant long-term time deposits. As in the rest of the euro area, there was a further pronounced decline in households' demand for such funds; insurers and pension funds continued to reduce such deposits.

Reduced credit provision by German banks to the private sector

In the July to September period, seasonally adjusted lending by domestic credit institutions to the domestic private sector contracted sharply, after expanding robustly just one quarter earlier. The seasonally adjusted and annualised three-month rate of change for total credit decreased from 4% in the second quarter to just under -4% in the reporting quarter. On balance, in the third quarter of 2010 there was a marked reduction in securitised lending to the private sector, which fell by a seasonally adjusted and annualised 11%, after having increased by 7% in the previous quarter. Furthermore, loans to the domestic private sector, which are more significant in terms of volume, declined. In the third quarter, the corresponding annualised and seasonally adjusted three-month rate stood at just under -3%, compared with 3½% in the previous quarter. It must be noted, however, that since the winter of 2009 this development has largely been determined by the dynamics of lending to financial corporations and has proved highly volatile owing to the financial market turmoil.

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

€ billion, seasonally adjusted

Item	2010 Q2	2010 Q3
Deposits of domestic non-MFIs 1		
Overnight	48.9	11.2
With agreed maturities		
of up to 2 years	– 28.3	0.9
of over 2 years	– 3.3	1.1
Redeemable at notice		
of up to 3 months	7.3	11.8
of over 3 months	– 3.1	– 5.8
Lending		
to domestic enterprises and households		
Loans	20.7	– 16.7
of which: to households 2	2.7	2.4
to non-financial corporations 3	1.4	– 3.3
Securities	5.5	– 9.5
to domestic general government		
Loans	13.2	– 3.4
Securities	22.5	6.8

***** 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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By contrast, discernible increase in loans to households

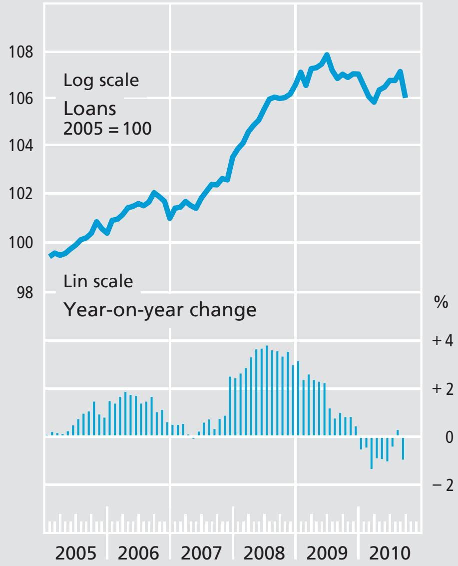
Net inflows in loans to the domestic private sector were recorded solely for loans to households in the third quarter of 2010. In annualised terms, the corresponding three-month rate stood at just over ½% in the third quarter, down from just under 1% in the previous quarter. While lending for house purchase rose perceptibly in the reporting quarter owing to the low interest rates available on such loans, the simultaneously observed sizeable reduction in consumer lending was offset by an equally large increase in other lending.

Lending to non-financial corporations sees outflows

German banks reduced their net lending to non-financial corporations in the reporting quarter. The corresponding annualised and seasonally adjusted three-month rate amounted to just over -1½% in the third

Loans of German banks to domestic enterprises and households*

Seasonally adjusted



* End of month; adjusted for statistical changes.

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quarter of 2010, compared with just over ½% in the previous quarter. However, this quarterly analysis masks the fact that on several occasions positive and negative net inflows alternated from one month to another in 2010, when viewed as a whole. The downward trend in credit momentum in Germany in 2009 therefore seems to be broken, but no turnaround with growing volumes is on the horizon yet. As far as the maturity structure is concerned, short and medium-term lending to non-financial corporations continued to decline during the reporting quarter. Moreover, the growth of long-term lending slackened after having gathered momentum in the first half of the year. All in all, however, if trends in loans to domestic non-financial corporations are compared with developments in the real economy in the third quarter of 2010 there is again no indication of a credit crunch in Germany. The as yet muted credit growth of non-financial corporations in Germany appears to be partly due to the improved internal financing options that have resulted from the economic recovery.

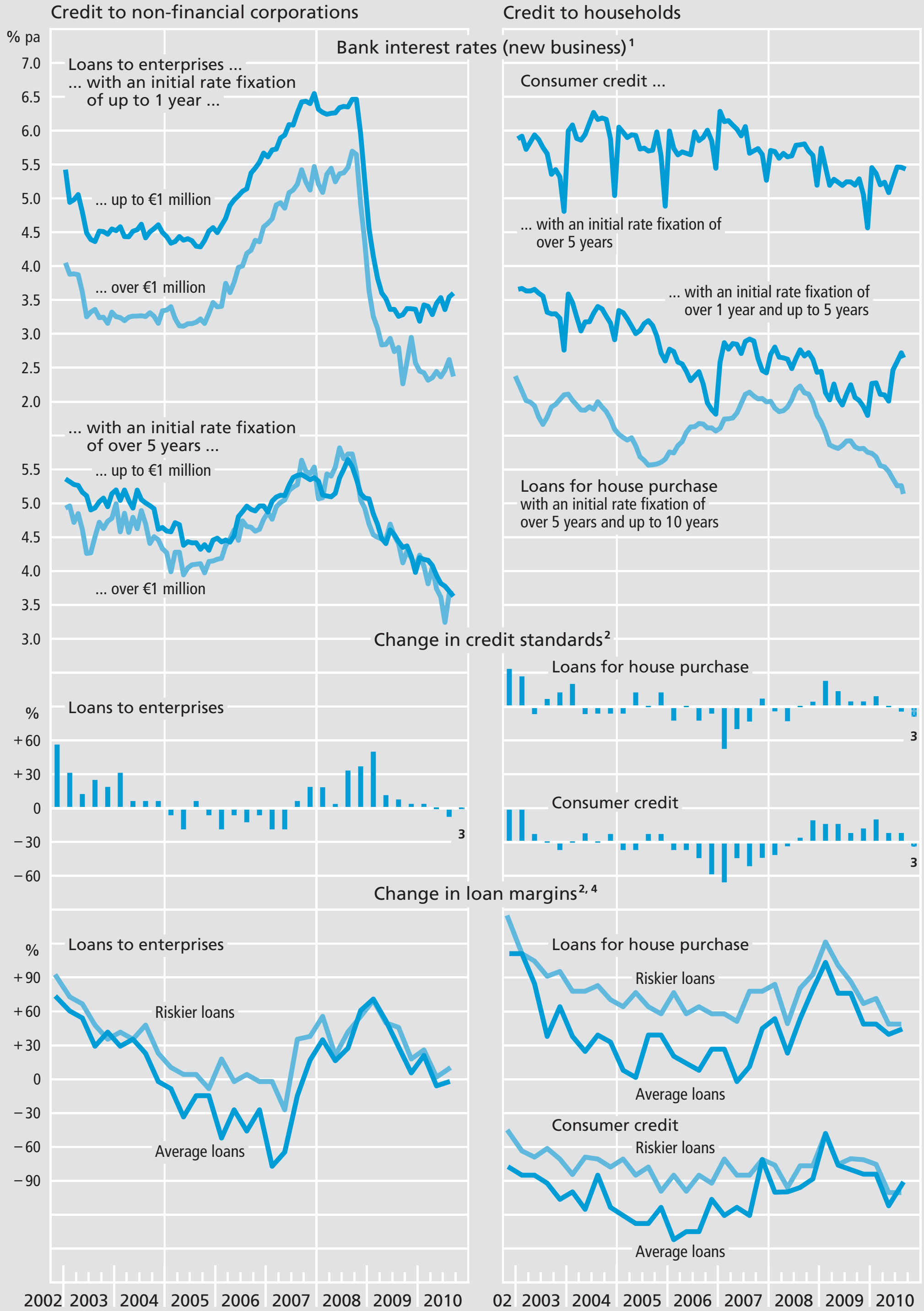
Further increase in credit to general government

In contrast to the credit extended to the private sector, German banks' net lending to German general government between July and September rose for the sixth time in a row, although on a very much reduced scale compared with the two preceding quarters. In seasonally adjusted and annualised terms, credit provision to the public sector increased by 2½%, which applied solely to securitised lending; standard loans to the public sector contracted significantly in the reporting quarter.

Credit standards for loans to enterprises were eased somewhat again for the first time ...

The results of the latest Bank Lending Survey (BLS) indicate only marginally changed credit supply conditions in Germany during the third quarter of 2010. For instance, credit standards applying to loans to enterprises were eased somewhat for the first time since the onset of the financial crisis. According to the banks surveyed, this was due, in particular, to the improvement in the outlook for general economic activity as well as the positive liquidity situation of these institutions. By contrast, large enterprises proved unable to benefit from this initial easing. As regards margins, enterprises with average credit ratings saw no additional adjustments while the margins on riskier loans were widened somewhat again. At the same time, participating bank managers spoke of significantly

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 Q4. — **4** Reduced scale.

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heightened demand in this line of business, which they mainly attributed to the sharp increase in financing needs for inventories and working capital. The banks expect little change to credit standards in the fourth quarter.

... though not for loans to households ...

Credit standards applying to private loans for house purchase remained virtually unchanged in the third quarter of 2010, whereas the standards for consumer credit were again tightened somewhat on account of households' lower creditworthiness. Above and beyond this, the surveyed bank managers stated that they had, in most cases, slightly tightened the margins for retail clients in both of the risk categories under review. Mirroring developments in commercial banking, the respondent bank managers observed a perceptible pick-up in demand for loans for house purchase while net demand for funds for consumption purposes was unchanged.

... or in the euro area as a whole

Unlike in Germany, credit standards for loans to enterprises were once again tightened somewhat in the third quarter across the euro area as a whole and, for the first time since the financial crisis began, remained basically unchanged only in the retail banking sector. The margin policy was likewise a little more restrictive than in the German sample and developments in demand throughout the currency area were also markedly weaker on balance.

Banks' access to wholesale funding somewhat improved again

The survey round for the third quarter of 2010 again contained additional questions on the impact of the financial crisis on wholesale funding, capital and lending of the participating banks. According to information supplied by German institutions, their access to wholesale funding on the money and capital markets was, in broad terms, somewhat better than in the previous quarter when, still suffering from the sovereign debt crisis, they had spoken of a certain deterioration in their access to market financing. At the same time, just over one-third of the German bank managers surveyed said capital costs were higher in the wake of the financial crisis. This also resulted in some lending constraints at no less than one-fifth of the institutions.

Little change or decline in bank lending rates

In the main, bank lending rates on new loans are likely to have supported domestic lending to the private sector. The reporting institutions recorded largely unchanged or declining lending rates again in the third quarter of 2010. Thus, interest rates on long-term loans for house purchase fell to 3.6%, which was in line with the interest rate for small long-term loans to non-financial corporations; at a rate of 3.7%, large loans were priced at a virtually identical level. For the most part, the rates for short-term loans to enterprises remained at the fairly low level recorded in the previous quarter and, depending on the size of the loan, stood at 3.6% and 2.4% respectively at last count.