# Monetary policy and banking business

## Monetary policy and money market developments

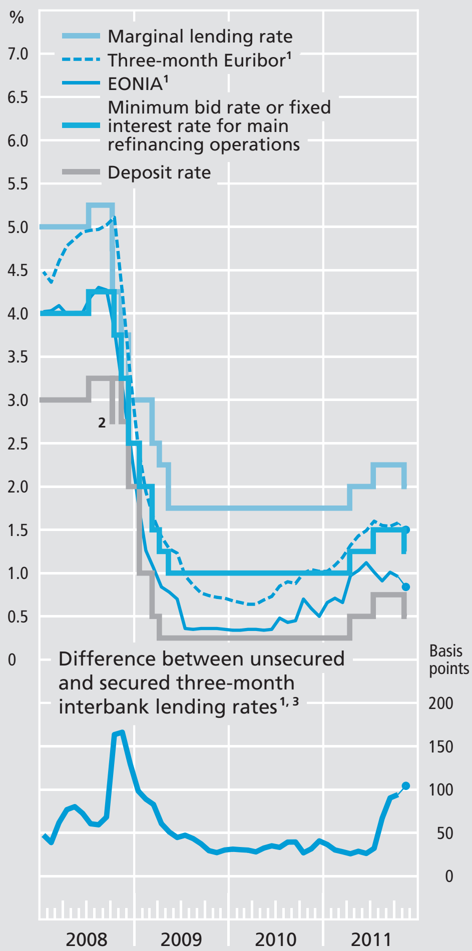
*ECB Governing Council lowers key interest rates by 25 bp*

Economic growth has weakened increasingly in the euro area during the course of 2011. At the same time, the economic outlook for the final quarter of this year and first quarter of next year and beyond has deteriorated noticeably since the middle of the year. This is partly due to the renewed intensification of the sovereign debt crisis and the concomitant pronounced uncertainty on financial markets. Overall, this development has led to a perceptible downward revision in growth expectations for 2012. Furthermore, it is expected that HICP inflation will decline appreciably in the coming months and thus return to the range of stability. The deterioration in macroeconomic prospects and its implications for the inflation outlook prompted the ECB Governing Council's decision to cut interest rates by 25 basis points at the beginning of November. Taking care to maintain the current corridor breadth of 150 basis points, the main refinancing rate has stood at 1.25% with effect from 8 November 2011, with the interest rate for recourse to the marginal lending facility set at 2% and the interest rate on the deposit facility at 0.5%.

*Rise in overnight rate in spite of high excess liquidity*

The temporary calm on financial markets at the beginning of the year has been followed by a significant deterioration of financial market conditions since the summer. As the crisis spread to other euro-area countries, growing uncertainty about banks' financing situation generated a massive rise in banks' demand for liquidity from the Eurosystem. In response to an escalation of this develop-

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 November 2011.

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ment mid-September, on 6 October the ECB Governing Council approved the renewed provision of longer-term liquidity for a period of around 12 months through two additional longer-term refinancing operations in October and December 2011; it also decided to continue to conduct all refinancing operations on the basis of full allotment for as long as necessary, and at least until 10 July 2012. Excess liquidity in the banking system consequently reached a level last observed in the summer of 2010. In the reporting period, EONIA was affected by two opposing forces. On the one hand, the abundant excess liquidity in the third quarter caused money market rates to stabilise significantly below the main refinancing rate. On the other hand, the greater uncertainty prevailing since the middle of September was reflected in the form of a risk premium, which led to the spread between EONIA and the rate on the deposit facility almost doubling in the past four months (to around 20 basis points on average throughout the last reserve maintenance period). The overnight rate is thus currently slightly above the weighted average rate of the liquidity-absorbing operations conducted in connection with the Securities Markets Programme. The significance of these operations for the Eurosystem's counterparties has increased significantly, as their volume has meanwhile risen to more than €180 billion, which approximately corresponds to the average use of the deposit facility in the last reserve maintenance period.

*Longer-term money market rates halt upward trend*

Given the recent worsening of the sovereign debt crisis, markets had anticipated an interest rate cut at the end of the year. Nevertheless, the interest rate move in November came as a surprise for market participants. Longer-term unsecured money market rates declined by as much as 9 basis points immediately after the announcement and completely reversed the increase of the past six months. Secured money market rates likewise experienced an immediate decline of up to 11 basis points, returning to the downward trend of the third quarter. As a result, even after the rate cut, the depo-repo spreads remained at the high level reached in the course of the third quarter. Irrespective of their underlying maturity, risk premiums have more than doubled compared with the average level of the last 2½ years, as money market rates for secured transactions saw a drastic decline during the third quarter, moving much closer to the deposit rate.

*Further non-standard measures announced in October 2011*

In order to counter the strained funding situation of euro-area banks, at its first meeting in the month of October 2011 the ECB Governing Council decided not only to further extend its longer-term liquidity provision but also to launch a second covered bond purchase programme, which will have a size of €40 billion, one-third smaller than the May 2009 programme.

## Monetary developments in the euro area

*Accelerated continuation of monetary expansion*

The expansion in the M3 monetary aggregate observed since the spring of 2010 continued at an accelerated pace in the third quarter of 2011. At a seasonally adjusted and annualised three-month rate of just over 7½%, the quarter-on-quarter increase was the highest since the fourth quarter of 2008. Heightened uncertainty on the financial markets was the main reason for the sharp rise in the M3 monetary aggregate. The annual growth rate of M3 increased from 2% at the middle of the year to 3% at the end of the reporting quarter on account of these influences. By contrast, loans to the domestic private sector have grown at an almost constant pace since the beginning of the year, at around 2½% on the year.

### Monetary developments in the euro area *

Changes in € billion, seasonally adjusted

| Monetary aggregate in a balance sheet context | 2011 | |
|---|---|---|
| | Q2 | Q3 |
| Monetary aggregate M3 (=1+2-3-4-5) | 54.9 | 181.5 |
| Components: | | |
| Currency in circulation and overnight deposits (M1) | 9.1 | 57.4 |
| Other short-term deposits (M2-M1) | 31.9 | 36.7 |
| Marketable instruments (M3-M2) | 13.8 | 87.4 |
| Counterparts | | |
| 1. Total credit to non-MFIs in the euro area | 16.5 | 114.0 |
| Credit to general government | – 26.7 | 63.8 |
| Credit to private-sector non-MFIs in the euro area | 43.2 | 50.3 |
| 2. Net external assets | 46.1 | 64.5 |
| 3. Central government deposits | 20.5 | – 29.9 |
| 4. Longer-term financial liabilities to other non-MFIs in the euro area | 90.8 | 63.2 |
| 5. Other counterparts of M3 (residual) | 103.6 | 36.3 |

* Changes for statistical reasons are eliminated.

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*Pronounced demand for marketable instruments and highly liquid components*

Whilst the expansion of M3 in the first half of 2011 was mainly driven by the growth of short-term time and savings deposits (M2-M1), the rise in marketable instruments (M3-M2) and in the highly liquid sub-component M1 was particularly marked over the summer months. In seasonally adjusted and annualised terms, the three-month rate for M1 was up on the quarter from (revised) 0.8% to 5%. This acceleration was mainly attributable to the strong increase in sight deposits, particularly in August. On top of this, cash holdings again increased significantly. Both increases are likely to have resulted from a rebalancing of portfolios, in the course of which market participants shifted their funds temporarily

## Money market management and liquidity needs

During the three reserve maintenance periods from 13 July to 11 October 2011, euro-area credit institutions' need for central bank liquidity as determined by autonomous liquidity factors fell significantly by €29.4 billion in net terms. The volume of banknotes in circulation rose by €8.7 billion in the period under review and therefore had, in contrast to overall developments, a liquidity-absorbing effect which, however, was more than offset by developments in the remaining factors. For one thing, general government deposits with the Eurosystem went down by €23.4 billion, resulting in a corresponding reduction in the demand for central bank liquidity. For another, if net foreign assets and other factors are taken together, a move which eliminates valuation effects with no impact on liquidity, there was an increase in liquidity needs of €14.7 billion in the period in question. The minimum reserve requirement dropped by a total of €1.5 billion during the three maintenance periods under review and further reduced the need for liquidity.

In the period under review, the Eurosystem continued to meet credit institutions' demand for central bank liquidity to the full amount. As liquidity-providing open-market operations continued to be carried out as fixed-rate tenders with full allotment (see table on page 30), the volume of liquidity provided through the tender operations was determined exclusively by the demand from credit institutions in the Eurosystem, meaning that demand often significantly exceeded the calculated requirement arising from autonomous factors and the minimum reserve requirement. This additional liquidity made it possible for the credit institutions to meet their minimum reserve requirements ahead of schedule in the period under review (frontloading) by holding a high level of reserves at the beginning of a reserve period.

In addition, given the renewed tensions in some financial markets in the euro area the Governing Council of the ECB decided at its meeting on 4 August 2011 to offer a further six-month tender in that same month. As with the three-month tenders, this was allotted at the fixed rate which is indexed to the average of the minimum bid rates of the main refinancing operations over the life of this operation. Moreover, at its meeting on 7 July 2011, the Governing Council of the ECB had already decided to raise its key policy rate by 25 basis points to 1.50%. The rates for the deposit and marginal lending facilities rose by the same margin to 0.75% and 2.25% respectively. The interest rate corridor thus remained symmetric at 75 basis points above and below the policy rate.

Notwithstanding the reduced need for liquidity related to the autonomous factors, the demand for liquidity in open-market operations rose perceptibly during the period under review, both in the case of main refinancing operations and longer-term refinancing operations. The volume of main refinancing operations increased over the three reserve periods by €47 billion while the overall volume of fixed-rate tenders grew by as much as €62 billion in the same period. With regard to the latter, the execution of the additional six-month tender had a particularly profound effect. As a result of this increase in demand for central bank liquidity which significantly exceeded the benchmarked amount, recourse to the deposit facility in the Eurosystem rose substantially and, comparing period averages, increased over the three reserve periods in net terms by €139 billion. Despite the overall amount of excess liquidity, the marginal lending facility was also used to a somewhat greater degree, especially towards the end of the observation period. Average use in the August-September reserve period stood at €1.5 billion, compared with €0.1 billion and €0.3 billion respectively in the two preceding periods. On the other hand, owing to the rise in excess liquidity, overnight rates were once again geared more closely to the deposit facility. In each of the three reserve periods under review, the overnight rates followed a different pattern. On the whole, however, they were considerably less volatile than in the preceding three periods, measured by the standard deviation of the EONIA rate.

Against the backdrop of a renewed worsening of the European sovereign debt crisis, the Eurosystem returned to purchasing bonds under the Securities Market Programme (SMP) from mid-August onwards. As a consequence, holdings of such securities expanded significantly during the period under review, by €89.8 billion, to reach a total of €164.0 billion, if matured securities are taken into account. The Eurosystem continued to carry out weekly, liquidity-absorbing fine-tuning operations in order to neutralise the liquidity-providing effect resulting from the SMP purchases. Across the three reserve periods, the respective intended volume was easily absorbed in the course of each and every SMP liquidity absorbing tender. During the same period, the volume of securities purchased under the Covered Bond Purchase Programme (CBPP) declined by €0.9 billion to €59.2 billion as a result of maturing covered bonds and revaluations. The volume of holdings thus remained close to its peak level of €61.1 billion which it reached at the beginning of July 2010 after the planned completion of the programme. Moreover, throughout the period under review, on the last day of each of the maintenance periods, the Eurosystem continued to carry out a fine tuning-operation with an overnight maturity in order to absorb a large proportion of the excess central bank liquidity no longer needed to meet reserve requirements.

In the July-August 2011 reserve period the new main refinancing rate of 1.50% was used for the first time, as decided by the ECB Governing Council in its 7 July meeting. This rate hike had no restrictive effect on demand in open market operations. Instead, the total outstanding tender volume (excluding liquidity-absorbing fine-tuning operations) climbed to €505 billion by the end of the reserve period and was thus up a significant €72 billion

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from its level at around the same time one period earlier. As the demand for liquidity from autonomous factors simultaneously remained almost unchanged (€279 billion compared with €275 billion in the previous period), the increased demand for liquidity led to a corresponding rise in excess liquidity, ie central bank liquidity over and above the benchmark amount. As a result, use of the deposit facility rose markedly to an average of €57 billion compared with €30 billion in the previous period. The increase in excess liquidity also left its mark on overnight money, leading to a gradual fall in rates as the period progressed. On average during the reserve period the EONIA stood at 1.09% and was thus 41 basis points below the main refinancing rate. In the previous period this gap was only 27 basis points. Secured overnight money trading on Eurex Repo's GC Pooling trading platform saw a similar development: on a volume-weighted average, the overnight rate was recorded at 1.02% – a clear 48 basis points below the key interest rate (previous period -34 basis points). On average over the period, both EONIA turnover and secured overnight turnover on GC Pooling rose only minimally by €27.1 billion and €12.9 billion respectively compared with the average volumes one period earlier (€26.0 billion and €11.6 billion respectively) and thus remained at a relatively low level.

In the August-September 2011 reserve period, the overall increase in demand for liquidity in open market operations continued apace. During this period, demand in the tender operations initially rose by a significant margin before gradually declining again. This was largely attributable to the additional six-month tender conducted in the first week for which the credit institutions in the Eurosystem put in bids totalling around €50 billion. Furthermore, a decline in the demand for liquidity from autonomous factors (€262 billion on average over the period) led to an additional rise in excess liquidity which the credit institutions in the Eurosystem utilised for pronounced frontloading. Added to this, the increase in liquidity excess triggered significantly increased recourse to the deposit facility (€122 billion on average throughout the period) and another decline in overnight rates. Throughout this period, the EONIA remained fairly constant, averaging 0.90%; the weighted overnight rate at GC Pooling also declined perceptibly to 0.84% on average over the period, fluctuating only marginally. At the same time, the average underlying turnovers barely changed (€26.9 billion for the EONIA and €14.6 billion in the case of GC Pooling).

The September-October 2011 reserve period was characterised by a continued rise in demand for central bank liquidity. Primarily in the case of the main refinancing operations, the level of demand rose significantly, averaging €193 billion over the period (€135 billion in the previous period). On balance, the outstanding tender volume (excluding liquidity-absorbing fine-tuning operations) rose throughout the period to €567 billion, up from €493 billion and €525 billion in the previous two periods. Since the demand for liquidity from autonomous factors again declined (to €244 billion on average), credit institutions in the Eurosystem had even more liquidity above the benchmark level at their disposal. This was reflected in the use of the deposit facility which went up to €169 billion on average. The more comfortable liquidity conditions, however, did not lead to a continued decline in overnight rates; the increased segmentation of the banking market is likely to have played a part in this. Instead, EONIA increased to 1.05% on average over the period, although at the end of the quarter (end-September) it had peaked at 1.46%. Despite the higher level of excess liquidity, EONIA turnover also rose to €32.6 billion. On average, secured overnight trading on GC Pooling demonstrated a similar development: a rise in weighted rates (to 0.96%) coupled with a simultaneous increase in turnover (€15.2 billion).

## Factors determining bank liquidity [1]

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

| Item | 2011 13 July to 9 Aug | 2011 10 Aug to 13 Sep | 2011 14 Sep to 11 Oct |
|---|---|---|---|
| I Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors | | | |
| 1 Banknotes in circulation (increase: –) | – 8.0 | + 1.0 | – 1.7 |
| 2 Government deposits with the Eurosystem (increase: –) | + 2.0 | + 19.1 | + 2.3 |
| 3 Net foreign assets [2] | + 7.7 | – 1.0 | + 30.7 |
| 4 Other factors [2] | – 6.7 | – 1.5 | – 14.5 |
| Total | – 5.0 | + 17.6 | + 16.8 |
| II Monetary policy operations of the Eurosystem | | | |
| 1 Open market operations | | | |
| (a) Main refinancing operations | + 25.7 | – 36.6 | + 57.9 |
| (b) Longer-term refinancing operations | + 9.9 | + 68.3 | – 16.2 |
| (c) Other operations | – 2.6 | + 13.5 | – 13.7 |
| 2 Standing facilities | | | |
| (a) Marginal lending facility | – 0.1 | + 0.2 | + 1.2 |
| (b) Deposit facility (increase: –) | – 27.2 | – 65.1 | – 46.9 |
| Total | + 5.7 | – 19.7 | – 17.7 |
| III Change in credit institutions' current accounts (I + II) | + 0.6 | – 2.0 | – 0.8 |
| IV Change in the minimum reserve requirement (increase: –) | – 1.1 | + 1.8 | + 0.8 |

**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 in € billion[2] | Marginal rate/fixed rate % | Allotment ratio % | Weighted rate % | Cover ratio [3] | Number of bidders |
|---|---|---|---|---|---|---|---|---|---|
| 13.07.11 | MRO (FRT) | 7 | 153.6 | – 24.9 | 1.50 | 100.00 | – | 1.00 | 230 |
| 13.07.11 | S-LTRO (FRT) | 28 | 67.7 | – | 1.50 | 100.00 | – | 1.00 | 57 |
| 13.07.11 | FTO (–) | 7 | – 74.0 | – | 1.50 | 30.76 | 1.39 | 1.24 | 64 |
| 20.07.11 | MRO (FRT) | 7 | 197.1 | 102.1 | 1.50 | 100.00 | – | 1.00 | 291 |
| 20.07.11 | FTO (–) | 7 | – 74.0 | – | 1.40 | 21.33 | 1.31 | 1.16 | 63 |
| 27.07.11 | MRO (FRT) | 7 | 164.2 | 53.2 | 1.50 | 100.00 | – | 1.00 | 193 |
| 27.07.11 | FTO (–) | 7 | – 74.0 | – | 1.25 | 38.13 | 1.09 | 1.26 | 69 |
| 28.07.11 | LTRO (FRT) | 91 | 85.0 | – | [4] 1.50 | 100.00 | – | 1.00 | 165 |
| 03.08.11 | MRO (FRT) | 7 | 172.0 | 157.5 | 1.50 | 100.00 | – | 1.00 | 168 |
| 03.08.11 | FTO (–) | 7 | – 74.0 | – | 0.99 | 49.60 | 0.92 | 1.17 | 68 |
| 09.08.11 | FTO (–) | 1 | – 145.1 | – | 1.30 | 100.00 | 1.27 | 1.00 | 121 |
| 10.08.11 | MRO (FRT) | 7 | 157.1 | 8.1 | 1.50 | 100.00 | – | 1.00 | 153 |
| 10.08.11 | S-LTRO (FRT) | 35 | 75.8 | – | 1.50 | 100.00 | – | 1.00 | 39 |
| 10.08.11 | FTO (–) | 7 | – 74.0 | – | 1.14 | 7.14 | 1.01 | 1.29 | 65 |
| 11.08.11 | S-LTRO (FRT) | 203 | 49.8 | – | [4] … | 100.00 | – | 1.00 | 114 |
| 17.08.11 | MRO (FRT) | 7 | 147.7 | 216.2 | 1.50 | 100.00 | – | 1.00 | 139 |
| 17.08.11 | FTO (–) | 7 | – 96.0 | – | 1.20 | 8.11 | 0.96 | 1.28 | 78 |
| 24.08.11 | MRO (FRT) | 7 | 133.7 | 240.7 | 1.50 | 100.00 | – | 1.00 | 133 |
| 24.08.11 | FTO (–) | 7 | – 110.5 | – | 1.15 | 16.15 | 1.03 | 1.20 | 91 |
| 31.08.11 | MRO (FRT) | 7 | 121.7 | 184.7 | 1.50 | 100.00 | – | 1.00 | 135 |
| 31.08.11 | FTO (–) | 7 | 115.5 | – | 1.14 | 8.45 | 1.02 | 1.32 | 98 |
| 01.09.11 | LTRO (FRT) | 91 | 49.4 | – | [4] … | 100.00 | – | 1.00 | 128 |
| 07.09.11 | MRO (FRT) | 7 | 115.4 | 205.9 | 1.50 | 100.00 | – | 1.00 | 126 |
| 07.09.11 | FTO (–) | 7 | – 129.0 | – | 1.05 | 88.03 | 1.00 | 1.35 | 100 |
| 13.09.11 | FTO (–) | 1 | – 167.0 | – | 1.30 | 100.00 | 1.27 | 1.00 | 130 |
| 14.09.11 | MRO (FRT) | 7 | 163.8 | 76.3 | 1.50 | 100.00 | – | 1.00 | 142 |
| 14.09.11 | S-LTRO (FRT) | 28 | 54.2 | – | 1.50 | 100.00 | – | 1.00 | 37 |
| 14.09.11 | FTO (–) | 7 | – 143.0 | – | 1.06 | 42.40 | 1.01 | 1.31 | 104 |
| 21.09.11 | MRO (FRT) | 7 | 201.1 | 215.6 | 1.50 | 100.00 | – | 1.00 | 153 |
| 21.09.11 | FTO (–) | 7 | 152.5 | – | 1.05 | 20.29 | 0.99 | 1.33 | 109 |
| 28.09.11 | MRO (FRT) | 7 | 208.3 | 145.8 | 1.50 | 100.00 | – | 1.00 | 159 |
| 28.09.11 | FTO (–) | 7 | – 156.5 | – | 1.15 | 62.14 | 1.05 | 1.30 | 103 |
| 29.09.11 | LTRO (FRT) | 84 | 140.6 | – | [4] … | 100.00 | – | 1.00 | 214 |
| 05.10.11 | MRO (FRT) | 7 | 198.9 | 275.4 | 1.50 | 100.00 | – | 1.00 | 166 |
| 05.10.11 | FTO (–) | 7 | – 160.5 | – | 1.02 | 16.77 | 0.96 | 1.50 | 100 |
| 11.10.11 | FTO (–) | 1 | – 273.8 | – | 1.30 | 100.00 | 1.27 | 1.00 | 153 |

* For more information on the Eurosystem's operations from 13 April 2011 to 12 July 2011, see Deutsche Bundesbank, Monthly Report, August 2011, p 27. — **1** MRO: main refinancing operation, LTRO: longer-term refinancing operation, S-LTRO: supplementary longer-term refinancing operation, FTO: fine-tuning operation (+: liquidity providing operation, –: liquidity absorbing operation), FRT: fixed-rate tender. — **2** Calculation according to publication after MRO allotment. — **3** Ratio of total bids to the allotment amount. — **4** The interest rate corresponds to the average minimum bid rate or main refinancing rate of the MROs conducted over the life of this operation.

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into highly liquid forms of investment, such as cash and overnight deposits. As regards other shorter-term bank deposits (M2-M1), the positive development seen in the previous quarters continued. However, their contribution to M3 growth in the summer months was considerably smaller than the contribution provided by the other components.

*Sharp rise in repo transactions*

Marketable instruments enjoyed particularly dynamic growth during the period under review, with their seasonally adjusted and annualised three-month rate rising from just under 5% at the end of June to just over 33½% at the end of September. This development was primarily driven by exceptional growth in repo transactions, which had already increased strongly in the previous quarter. The sharp rise in secured interbank transactions settled through central counterparties was the main reason for this increase. In this respect there is also a direct link between this development and the greater level of uncertainty. Bank debt securities included in (M3-M2) and money market fund shares that are redeemable on a daily basis also increased discernibly, with the latter recording a positive inflow for the first time in more than two years.

*Moderate increase in credit to the domestic private sector*

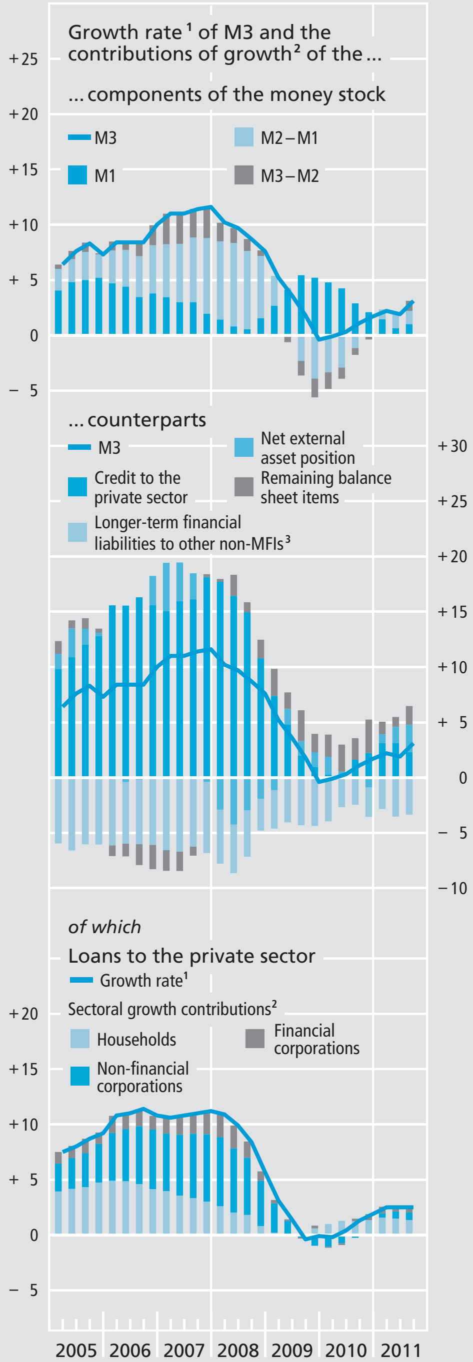
Among the counterparts of M3, loans to non-banks grew appreciably again in the third quarter after weaker growth in the first half of 2011, with growth divided almost equally between credit to general government and credit to the private sector in the euro area. With respect to credit to the domestic private sector, in the reporting quarter loans increased somewhat more strongly than in the previous quarter at a seasonally adjusted and annualised three-month rate of just under 2½%. The contribution of lending to financial corporations to the growth of this credit aggregate increased considerably in the summer quarter. These loans are largely made up of the offsetting positions to the repo transactions included in (M3-M2).

*Increase in credit to non-financial private sector slows down further*

By contrast, the growth in loans to the non-financial private sector slowed down again, this time appreciably, compared with the previous quarter. The seasonally adjusted and annualised increase in loans to households came in at just under 1% and was thus down on the quarter once again (previously 2%). For one thing, growth in lending for house purchase, the major component of household borrowing, weakened again. For an-

## Components and counterparts of the money stock in the euro area

Seasonally adjusted, end-of-quarter data




**1** Year-on-year change in percent. — **2** In percentage points. — **3** Taken in isolation, an increase curbs M3 growth.

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

Changes in € billion, seasonally adjusted

| Item | 2011 Q2 | 2011 Q3 |
|---|---|---|
| Deposits of domestic non-MFIs 1 | | |
| Overnight | 7.7 | 28.0 |
| With agreed maturities | | |
| of up to 2 years | 19.3 | 27.2 |
| of over 2 years | – 2.2 | – 2.2 |
| Redeemable at notice | | |
| of up to 3 months | – 1.3 | – 0.7 |
| of over 3 months | 0.4 | 0.2 |
| Lending | | |
| to domestic general government | | |
| Loans | – 23.9 | – 10.2 |
| Securitised lending | – 2.1 | – 1.7 |
| to domestic enterprises and households | | |
| Loans | 13.9 | 23.9 |
| *of which* to households 2 | 2.6 | 3.1 |
| to non-financial corporations 3 | – 1.7 | 4.3 |
| Securitised lending | – 5.1 | – 5.2 |

* As well as banks (including building and loan associations, but excluding the Bundesbank), monetary financial institutions (MFIs) here also include money market funds. End-of-quarter data, adjusted for statistical changes.— 1 Enterprises, households and general government excluding central government. — 2 Including non-profit institutions serving households.— 3 Non-financial and quasi-corporations.

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other, loans for consumption saw a decline, albeit smaller than in the previous quarter. The upward movement for loans to non-financial corporations also slowed again in the reporting quarter. Lending to this sector was heavily focused on long-term maturities in the reporting quarter, whilst medium-term loans virtually stagnated and short-term loans actually fell slightly. It should, however, be borne in mind that data on lending to non-financial corporations cover the entire euro area and mask very heterogeneous developments in the individual member states.

*Considerable increase in credit to general government*

In contrast to the previous quarter, credit to general government also increased significantly during the July-September period. This growth was solely attributable to purchases made by the Eurosystem under its Securities Markets Programme, while monetary financial institutions (excluding the Eurosystem) reduced their exposure in this area. At the same time, there was a discernible decrease in the deposits of central governments, which are not part of the monetary aggregate M3. This had an overall positive impact on the increase in the monetary aggregate M3 in the third quarter of 2011.

*Noticeable rise in net external position along with significant monetary capital formation*

Taken in isolation, the continuous growth of the euro-area banking sector's net external assets since the beginning of the year, which accelerated somewhat again in the reporting quarter, also contributed to monetary growth. This was caused by an appreciable decline in external liabilities combined with almost unchanged external claims. However, this positive effect was again restrained by significant monetary capital formation, which was primarily driven by strong capital formation and accumulation of reserves, but also by a marked increase in long-term time deposits (with a maturity of over two years). The dampening impact of monetary capital formation on monetary growth was noticeably weaker in the third quarter than in the previous period, however.

*Money-based forecasts with balanced inflation risks*

Inflation forecasts on the basis of various monetary indicators (monetary aggregates, short-term deposits, loans) currently signal balanced risks for price stability for the next three years on average. However, the uncertainty inherent in such forecasts has been rising almost uninterruptedly since the beginning of the financial crisis and has currently reached a new record. This is mainly due to the fact that the various monetary indicators are increasingly sending out divergent signals. For example, the forecasts based on M3 growth indicate heightened inflation risks, whereas those on the basis of the growth of M1 and of loans to households are well below 2%.

## German banks' deposit and lending business with domestic customers

*Strong growth in short-term deposits*

With a seasonally adjusted and annualised three-month rate of 7½%, German banks' deposit business has grown much more strongly this quarter than in the previous two quarters. The dynamic growth of time deposits with a maturity of up to two years and of overnight deposits were decisive factors here; an increased use of both types of deposits could be observed for all private sectors. In contrast to the euro area as a whole, short-term time deposits increased again strongly in Germany. Without this German contribution, the holdings of short-term time deposits in the euro area would have even declined in seasonally adjusted terms. One major reason for the increased accumulation of short-term deposits compared with the previous quarter is likely to have been the heightened uncertainty on capital markets, which had already led to portfolio shifts into short-term deposits in the second quarter. The still favourable development in terms of interest rates on these deposits compared with the remuneration of longer-term investments may also have played a role.

*Reduction of longer-term deposits continues*

As in previous quarters, domestic customers' longer-term deposits with credit institutions in Germany shrank further on balance in the third quarter. This decline was in particular due to outflows from time deposits with an agreed maturity of more than two years, as holdings of longer-term savings deposits stagnated. The continuing decline in deposits held by financial corporations was a key factor with respect to the reduction of longer-term time deposits. By contrast, households increased their holdings of longer-term time deposits, albeit less strongly than in the previous quarter.

*Slight increase in banks' lending to domestic non-banks*

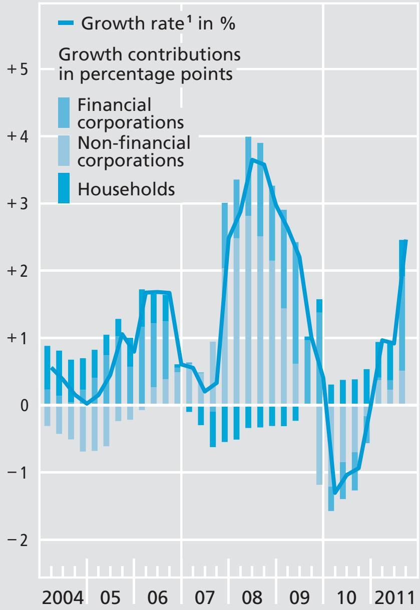
German banks' credit to domestic non-banks increased again slightly in the third quarter of 2011, growing at a seasonally adjusted and annualised three-month-rate of just under 1%, after two successive declines in the previous quarters. This growth was driven by credit to the domestic private sector, while credit to general government remained on the decline. The main reason for the expansion in credit to the private sector was the strong increase in loans, which saw their three-month rate accelerate to 4%. Loans to financial corporations constituted the largest share; they rose predominantly due to an expansion of secured interbank transactions conducted through central counterparties in August. However, such loans do not entail any increased provision of credit to the private non-bank sector.

*Increased lending to non-financial corporations*

In addition to loans to financial corporations, German banks also increased their loans to domestic non-financial corporations and households appreciably in the reporting quarter. The seasonally adjusted and annualised three-month rate for loans to non-financial

Loans of German banks to selected sectors

Seasonally adjusted, end-of-quarter data




1 Year-on-year rate of change.

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corporations increased at the end of the reporting quarter to just over 2%. The recovery in lending to this sector, which had set in during the first quarter, therefore continued, following a decline in the second quarter. The growth in loans to domestic non-financial corporations was mainly characterised by an increase in short-term loans with a maturity of up to one year. By contrast, there was a decline in the medium-term maturity segment – a decline which was, however, less pronounced in comparison with the previous quarter. Longer-term loans to domestic non-financial corporations only grew by a small margin. This differed from the overall development in the euro area, where expanded lending to non-financial corporations was almost exclusively composed of longer-term loans. With respect to Germany, more loans to this sector were extended by almost all the important categories of banks, with the exception of the Landesbanken, which slightly reduced their lending to non-financial corporations.

*Increase in loans for house purchase and credit for consumption*

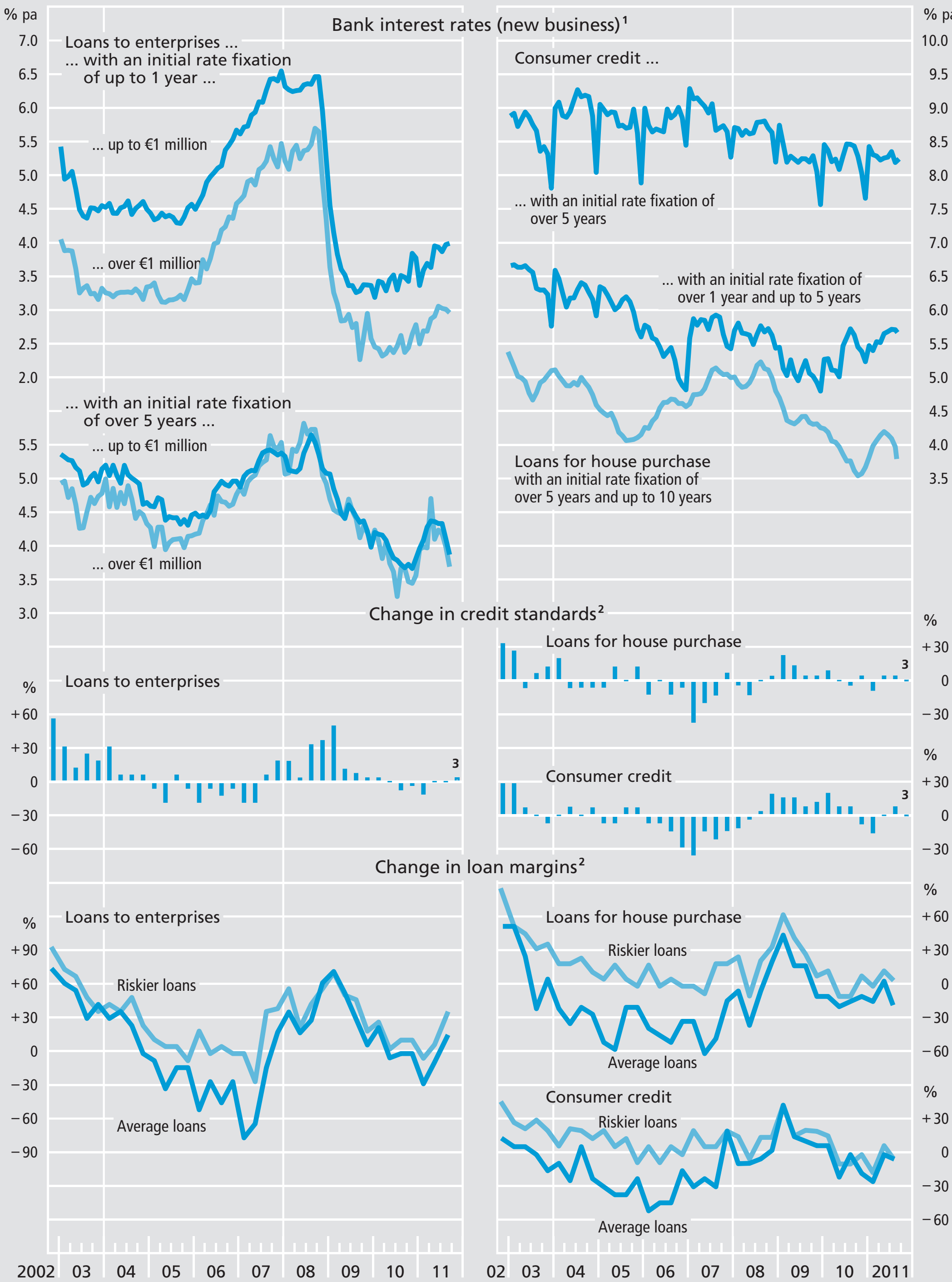
Loans from German banks to households in Germany grew by 1% in seasonally adjusted and annualised terms during the reporting quarter, representing a slightly stronger rise than in the previous quarter. The growth of this credit aggregate thus remains in line with the trend observed since the beginning of 2010. Cooperative banks and savings banks made the strongest contribution to this expansion. The increase in household debt with banks arose from a marked expansion of credit for consumption combined with a further increase in lending for house purchase, which, however, saw somewhat weaker growth than in the previous quarter.

*German banks' lending policies show signs of tightening*

According to the data submitted by German banks as part of the Bank Lending Survey (BLS), in the third quarter there were divergent developments with regard to the lending policy, which tended toward a more restrictive stance.[1] For the first time in three quarters, the credit institutions applied slightly stricter standards for consumer credit overall. By contrast, credit standards remained virtually unchanged for corporate clients and house purchase alike. A heterogeneous development was also observed in banks' margin policy. On the one hand, the margins for loans to enterprises were signifi-

1 The aggregate survey results for Germany may be found at www.bundesbank.de/volkswirtschaft/vo_veroeffentlichungen.en.php.

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 2011 Q4.

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cantly expanded in some cases. This mainly applied to riskier exposures with the chief focus on loans to large enterprises. On the other hand, most of the surveyed institutions reported broadly unchanged margins for loans to households. According to the responses supplied by these institutions, no major adjustments with regard to credit standards are expected for the fourth quarter of 2011, with the exception of a planned slight tightening for long-term loans to enterprises.

*Reduced dynamics in credit demand in Germany*

At the same time, there was an increase in the demand for credit from the reporting banks both for corporate and for retail lending. Nevertheless, the credit institutions reported a noticeable deceleration in demand for funds compared with the previous quarter, in particular for loans to enterprises and loans for consumption.

*Less heterogeneity of supply conditions across euro area*

In the third quarter, changes in credit supply conditions in the euro area remained heterogeneous but not as diverse as before. Compared with the previous quarters, between July and September credit supply conditions were tightened in an increasing number of euro-area countries. As a result, in aggregate terms there was a perceptible tightening of conditions across all three surveyed lending categories coupled with a general decline in demand.

*Financial and sovereign debt crisis has negative impact on banks' refinancing*

The BLS survey for the third quarter again contained an *ad hoc* question on the impact of the financial and sovereign debt crisis on credit institutions' refinancing conditions. According to information provided by the reporting institutions, both for the German sub-sample and for the overall sample of European banks, access to wholesale funding, primarily on money and capital markets, worsened significantly on balance compared with the preceding quarter.

*Overall decrease in interest rates on bank loans*

Data provided by the reporting institutions showed that lending rates were down on the quarter. This is especially true of loans with long rate fixation periods, while those with short fixation periods only saw small but more heterogeneous changes. The interest rates on long-term loans for enterprises fell sharply by around 50 basis points on the quarter, with the effect that the interest rates on large-scale (small-scale) loans stood at 3.7% (3.9%). In addition, long-term loans to households for the purpose of house purchase also saw a notable drop in lending rates by around 50 bp to 3.8% on average, while the interest rates on longer-term consumer credit remained broadly unchanged. Hence, bank lending rates only partially mirrored the falling yields on German bonds, which is in line with the historical pattern of a lagged interest rate pass-through.