Monetary policy and banking business

Monetary policy and money market developments

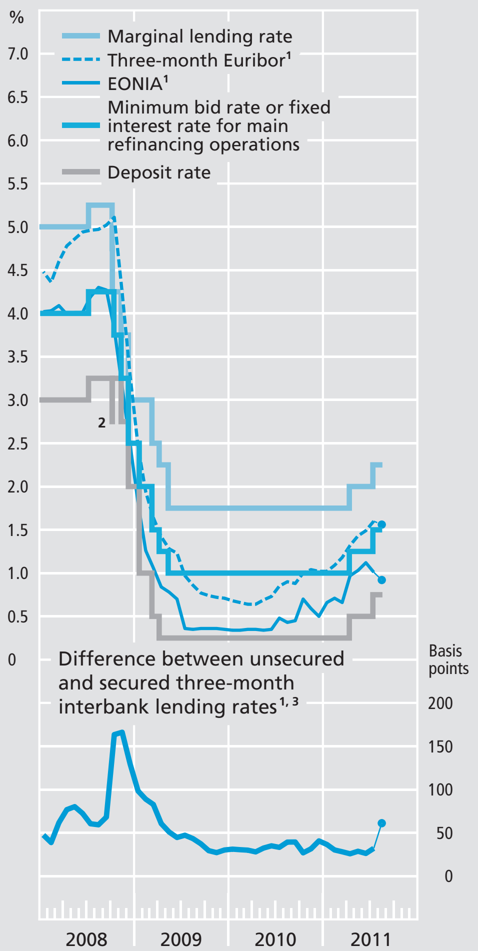
ECB Governing Council raises key interest rates again by 25 bp

Following a sharp increase in economic output in the euro area during the first quarter, growth levelled off to a much flatter path in the second quarter of the year as expected. This recovery was spurred on by the ongoing expansionary monetary policy. However, in the months under review, HICP inflation remained well above 2%, mainly on account of energy and commodity prices. In order to counter the resultant medium-term upside risks to price stability and anchor inflation expectations at a level consistent with price stability, the Governing Council of the ECB decided in July that, following the interest rate increase in April, its accommodative monetary policy required further tightening. Taking care to maintain the current corridor breadth of 150 basis points, it raised the key ECB interest rates by 25 basis points. With effect from 13 July 2011, the main refinancing rate has stood at 1½%, with the interest rate for recourse to the marginal lending facility and the interest rate on the deposit facility set at 2¼% and ¾% respectively.

Overnight interest rate under pressure from rising excess liquidity

At the start of the second quarter of 2011, banks initially continued to reduce their surplus liquidity, a course they had been pursuing since the beginning of the year. Temporary fluctuations in liquidity conditions led to increased volatility in the overnight market interest rates, as in the previous quarter. At the mid-quarter stage the money market rates stabilised slightly below the key interest rate for a time. However, the growing uncertainty on the financial markets put an end to this temporary normalisation of the money market in mid-June.

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 17 August 2011.

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Since then, banks' rapidly increasing borrowing from the Eurosystem has caused excess liquidity in the banking system to reach a level last observed in the fourth quarter of 2010. Moreover, banks resorted more and more to fulfilling their minimum reserve requirements early in the maintenance period (frontloading), which meant that money market rates increasingly tended to fall over the course of each maintenance period in a pattern that is typical of situations characterised by abundant excess liquidity.

Longer-term money market rates halt upward trend

With the sovereign debt crisis worsening and uncertainty rife on the financial markets, since the end of the second quarter the Eurosystem's monetary policymakers have been faced with the challenge of meeting banks' increased demand for liquidity while simultaneously addressing the threats posed to price stability in an appropriate and timely manner. Once again, the clear segregation of liquidity-providing measures, on the one hand, and the monetary policy stance as expressed in interest rate decisions, on the other, has proved the right course of action. Accordingly, the rise in the key interest rate which occurred in July was correctly anticipated by the markets and duly reflected in higher longer-term unsecured money market rates. The upward shift was, however, greatly weakened compared with the previous quarter, in particular for longer maturities. By contrast, since the recent worsening of the sovereign debt crisis in July 2011, the secured money market rates (Eurepo), and in particular those for longer maturities, have dropped significantly with the result that depo-repo-spreads have almost doubled in size compared with the first-quarter averages. Irrespective of the underlying maturity, these risk premiums are thus currently well above their average recorded level over the last 2½ years.

Continued use of full allotment alongside a renewed expansion of longer-term liquidity provision

Faced with renewed tensions in some euro-area financial markets, the Governing Council decided in early August to continue conducting all refinancing operations as fixed-rate tenders with full allotment for as long as needed, but at least until the end of 2011, and to conduct

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
13.04.11	MRO (FRT)	7	94.1	– 56.4	1.25	100.00	–	1.00	161
13.04.11	S-LTRO (FRT)	28	83.7	–	1.25	100.00	–	1.00	40
13.04.11	FTO (–)	7	– 77.0	–	1.12	88.00	1.05	1.33	71
20.04.11	MRO (FRT)	7	97.4	23.4	1.25	100.00	–	1.00	181
20.04.11	FTO (–)	7	– 76.0	–	1.21	91.14	1.12	1.17	68
27.04.11	MRO (FRT)	7	117.9	– 34.1	1.25	100.00	–	1.00	241
27.04.11	FTO (–)	7	– 71.4	–	1.25	100.00	1.17	1.00	49
28.04.11	LTRO (FRT)	91	63.4	–	[4] 1.29	100.00	–	1.00	177
04.05.11	MRO (FRT)	7	127.5	53.5	1.25	100.00	–	1.00	326
04.05.11	FTO (–)	7	– 62.2	–	1.25	100.00	1.16	1.00	58
10.05.11	FTO (–)	1	– 143.1	–	1.05	100.00	1.01	1.01	152
11.05.11	MRO (FRT)	7	124.8	– 31.7	1.25	100.00	–	1.00	247
11.05.11	S-LTRO (FRT)	35	80.7	–	1.25	100.00	–	1.00	60
11.05.11	FTO (–)	7	– 76.0	–	1.15	69.16	1.09	1.00	72
18.05.11	MRO (FRT)	7	119.4	63.9	1.25	100.00	–	1.00	235
18.05.11	FTO (–)	7	– 76.0	–	1.16	23.17	1.08	1.13	74
25.05.11	MRO (FRT)	7	116.1	30.1	1.25	100.00	–	1.00	241
25.05.11	FTO (–)	7	– 75.0	–	1.25	38.14	1.14	1.09	62
26.05.11	LTRO (FRT)	98	48.1	–	[4] …	100.00	–	1.00	182
01.06.11	MRO (FRT)	7	110.8	57.8	1.25	100.00	–	1.00	174
01.06.11	FTO (–)	7	– 75.0	–	0.89	41.39	0.81	1.38	69
08.06.11	MRO (FRT)	7	102.4	28.9	1.25	100.00	–	1.00	145
08.06.11	FTO (–)	7	– 75.0	–	1.03	39.80	0.90	1.25	71
14.06.11	FTO (–)	1	– 29.6	–	1.05	100.00	1.04	1.19	77
15.06.11	MRO (FRT)	7	135.6	– 40.4	1.25	100.00	–	1.00	235
15.06.11	S-LTRO (FRT)	28	69.4	–	1.25	100.00	–	1.00	60
15.06.11	FTO (–)	7	– 75.0	–	1.25	91.82	1.20	1.00	61
22.06.11	MRO (FRT)	7	186.9	84.4	1.25	100.00	–	1.00	353
22.06.11	FTO (–)	7	– 74.0	–	1.24	1.73	1.15	1.13	56
29.06.11	MRO (FRT)	7	141.5	– 10.5	1.25	100.00	–	1.00	232
29.06.11	FTO (–)	7	– 74.0	–	1.25	88.75	1.17	1.01	57
30.06.11	LTRO (FRT)	91	132.2	–	[4] …	100.00	–	1.00	265
06.07.11	MRO (FRT)	7	120.0	84.5	1.25	100.00	–	1.00	185
06.07.11	FTO (–)	7	– 74.0	–	0.90	92.08	0.75	1.30	68
12.07.11	FTO (–)	1	– 74.8	–	1.05	100.00	1.03	1.01	119

* For more information on the Eurosystem's operations from 19 January 2011 to 12 April 2011, see Deutsche Bundesbank, Monthly Report, May 2011, p 29. — **1** MRO: main refinancing operation, LTRO: longer-term refinancing operation, S-LTRO: supplementary longer-term refinancing operation, FTO: fine-tuning operation (+: liquidity providing operation, –: liquidity absorbing operation), FRT: fixed-rate tender. — **2** 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 of the MROs conducted over the life of this operation.

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a one-off supplementary longer-term refinancing operation at the beginning of August to provide liquidity for approximately six months. With the sovereign debt crisis spreading to other euro-area member states, the Governing Council also reactivated its Securities Markets Programme (SMP), which had been adopted in May 2010. This would, it argued, help restore better monetary policy transmission.[1]

Monetary developments in the euro area

Continued moderate monetary expansion

The increase in the M3 monetary aggregate that has been apparent since the spring of 2010 continued in the second quarter of 2011. However, at a seasonally-adjusted and annualised three-month rate of 2½%, the quarter-on-quarter increase remained moderate. Parallel

1 Statement issued by the ECB's President on 7 August 2011.

Money market management and liquidity needs

During the three reserve maintenance periods from 13 April to 12 July 2011, euro-area credit institutions' need for central bank liquidity determined by autonomous liquidity factors rose by €16.6 billion in net terms. This increase was due to the higher demand for bank notes, which rose by a total of €21.8 billion in the period under review. At the same time, general government deposits with the Eurosystem were virtually unchanged on balance. They rose by a mere €0.3 billion. The remaining autonomous factors showed a contrary development. If the net foreign reserves and the other factors are taken together, a move which eliminates liquidity-neutral valuation effects, there was a decline of €5.5 billion in the resulting liquidity needs in the period under review. The need for central bank liquidity stemming from the minimum reserve requirements decreased by a total of €1.6 billion over the three maintenance periods; the credit institutions were able to fulfil the minimum reserve requirements without any difficulty.

The Eurosystem continued the policy it has practiced for some time of generous liquidity provision during the period under review; it fully met the demand of credit institutions for central bank liquidity – beyond the regular liquidity needs (benchmark amount). Liquidity-providing open-market operations continued to be carried out as fixed-rate tenders with full allotment of the submitted bids (see table on page 27); the size of the liquidity provided through the tender operations was determined exclusively by the demand from credit institutions in the Eurosystem.

At its meeting on 7 April 2011, the Governing Council of the ECB decided to raise the key interest rate of 1.00%, in place since May 2009, by 25 basis points to 1.25%. The new main refinancing rate and the increased rates for the deposit and marginal lending facility (also up by 25 basis points to 0.50% and 2.00% respectively) applied for the first time in the April-May 2011 maintenance period.

The demand for liquidity in the open market operations increased in the period under review, which however was only partly due to the higher liquidity needs related to the autonomous factors. This increased demand was accompanied by a marked shift in the maturity structure. In net terms, the volume of longer-term refinancing operations decreased by approximately €24 billion during the three reserve maintenance periods, while at the same time the volume of main refinancing operations increased by around €49 billion in comparison. The demand for central bank liquidity over and above the increased liquidity need was reflected in a higher average recourse to the deposit facility in the Eurosystem. In the period under review it rose by just under €7 billion net. By contrast, in most instances, the marginal lending facility was used only sparingly, with average recourse in the three reserve periods of just around €350 million, €50 million and €220 million respectively. In addition to these developments, the overnight rates were very volatile during the period in question, partly as a result of prevailing liquidity conditions, but also due to special factors such as public holidays or the end of the half-year.

No purchases were made as part of the Securities Market Programme (SMP) in the period under review. The Eurosystem holdings declined by around €2.7 billion to a total of €74.2 billion during this period on account of matured securities. Weekly liquidity-absorbing fine-tuning operations, in place since the launch of the programme, continued to be carried out, in order to neutralise the liquidity-providing effect resulting from the SMP purchases. This aim was accomplished in the course of most of the SMP liquidity absorbing tenders. Only the April-May reserve period saw some underbidding; in both cases this was in particular due to the somewhat scarce liquidity supply and special effects over the Easter holidays. Moreover, on the last day of each of the reserve periods, the Eurosystem continued to carry out a liquidity-absorbing fine-tuning operation in order to withdraw excess central bank liquidity no longer needed to meet reserve requirements.

The April-May 2011 reserve period was characterised by mainly scarce liquidity conditions, which in some instances led to relatively high overnight rates. Particularly in the second and third week of the reserve period, which also included the Easter holidays, the decidedly small liquidity surplus, ie central bank liquidity exceeding the benchmark amount, made itself felt, resulting in EONIA fixings above the main refinancing rate of 1.25%. EONIA reached a peak of 1.43% during this period on the Thursday before Easter. The total outstanding tender volume (excluding liquidity-absorbing fine-tuning operations) rose from €418 billion at the beginning of the reserve period to €444 billion in the last week; it was, however, initially accompanied by a likewise increasing liquidity need due to autonomous factors. It was only the more comfortable liquidity conditions in the last days of the reserve period which led to a marked decline in overnight rates combined with increasing recourse to the deposit facility. Daily use of the deposit facility averaged €23 billion over the period, unchanged from the previous period. The predominantly scarce liquidity supply led to an EONIA average of 1.12% in this period, ie 13 basis points below the main refinancing rate. In the previous period this gap was still 33 basis points. With these higher overnight rates the underlying EONIA turnovers, which averaged €39.1 billion, remained close to the relatively high level of the previous period (€39.4 billion). With regard to secured overnight money trading on GC Pooling of Eurex Repo the rates followed a similar path to EONIA. On a volume-weighted average, the overnight rate stood at 1.13% and was thus also noticeably closer to the main refinancing rate than it had been in the previous period (-12 basis points as compared to -37 basis points in the March-April period). At an average of €9.9 billion, the corresponding turnovers were down somewhat on the previous period (€11.5 billion).

The May-June reserve period initially followed the typical pattern. Pronounced frontloading by the credit institutions in the Eurosystem, ie the holding of a relatively high level of reserves to meet their minimum reserve requirements sooner, in the environment of sufficient excess liquidity, initially led to overnight rates hovering close to, though still below, the main refinancing rate. As the reserve period went on, the increasingly favourable liquidity conditions and the aforementioned reserve fulfilment behaviour of the credit institutions brought about a fall in EONIA fixings (down to 0.85%). The Whitsun holiday at the end of the reserve period curtailed this development, however. Fortified by a rather small demand of €102 billion vis-à-vis the benchmark, the last main refinancing operation of the period saw a significant rise in overnight rates; EONIA was fixed at 1.55% on the Friday before Whitsun, ie 30 basis points above the key interest rate. EONIA was recorded at 1.08% on average over the period, though with considerably lower turnovers. These fell to an average of €29.4 billion during the period and were thus almost €10 billion lower than the previous period, indicating aggravated tensions and a further intensified segmentation of the interbank market. In contrast, the secured overnight turnover on GC Pooling rose to €11.5 billion, although the overnight rates were very volatile here too, with the reference rate up to 1.63%. The weighted overnight rate at GC Pooling averaged 1.08%.

The June-July reserve period began with overnight rates above the main refinancing rate of 1.25%. This was attributable to the relatively strong frontloading of credit institutions with somewhat scarce liquidity. In response to these conditions, the banks raised their bids in the second main refinancing operation of the reserve period significantly by €51 billion to €187 billion. The additional liquidity available triggered a rapid decline in the overnight rates. The liquidity situation remained very comfortable throughout the reserve period causing EONIA to fall yet further to stand at 0.59%, close to the deposit facility rate. Apart from the usual rise at the end of the reserve period, the half-year end proved an exception, with EONIA jumping to 1.72%. In total it averaged 0.98% over the period and was accompanied by a further drop in turnovers (€26 billion on average). Secured overnight rates at GC Pooling experienced a similar development; on average, the reference rate for secured overnight money stood at 0.91% and the underlying turnovers averaged €11.6 billion. The liquidity situation of the credit institutions was more comfortable overall in comparison to the previous period. This was also reflected in a higher recourse to the deposit facility which averaged €30 billion over the period (compared with just €18 billion in the previous period).

In the subsequent July-August reserve period the main refinancing rate of 1.50% was used for the first time, following the ECB Governing Council's decision in its meeting on 7 July 2011 to raise the key interest rate once again by 25 basis points.

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 Apr to 10 May	11 May to 14 June	15 June to 12 July
I Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors			
1 Banknotes in circulation (increase: –)	– 9.5	– 2.7	– 9.6
2 Government deposits with the Eurosystem (increase: –)	+ 11.8	– 1.3	– 10.8
3 Net foreign assets [2]	– 18.2	+ 0.9	+ 6.8
4 Other factors [2]	+ 16.4	– 3.7	+ 3.3
Total	+ 0.5	– 6.8	– 10.3
II Monetary policy operations of the Eurosystem			
1 Open market operations			
(a) Main refinancing operations	+ 11.9	+ 5.5	+ 31.3
(b) Longer-term refinancing operations	– 14.9	– 2.6	– 6.3
(c) Other operations	+ 1.7	– 0.5	– 2.0
2 Standing facilities			
(a) Marginal lending facility	– 0.4	– 0.4	+ 0.2
(b) Deposit facility (increase: –)	+ 0.2	+ 4.4	– 11.1
Total	– 1.5	+ 6.4	+ 12.1
III Change in credit institutions' current accounts (I + II)	– 1.0	– 0.5	+ 1.9
IV Change in the minimum reserve requirement (increase: –)	+ 1.1	+ 1.3	– 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.

Monetary developments in the euro area *

Changes in € billion, seasonally adjusted

Monetary aggregate in a balance sheet context	2011 Q1	2011 Q2
Monetary aggregate M3 (=1+2-3-4-5)	40.8	58.3
Components:		
Currency in circulation and overnight deposits (M1)	14.4	– 4.8
Other short-term deposits (M2-M1)	40.4	32.8
Marketable instruments (M3-M2)	– 14.0	30.3
Counterparts		
1. Total credit to non-MFIs in the euro area	20.3	3.7
Credit to general government	– 48.5	– 30.5
Credit to private-sector non-MFIs in the euro area	68.8	34.1
2. Net external assets	158.4	45.9
3. Central government deposits	– 20.5	19.9
4. Longer-term financial liabilities to other non-MFIs in the euro area	80.9	75.8
5. Other counterparts of M3 (residual)	– 77.5	104.4

* Changes for statistical reasons are eliminated.

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to the inflow of funds from abroad, the expanded granting of loans to the private sector that was already discernible in the previous quarter continued apace. The renewed drop in loans to general government, along with the ongoing clear increase in monetary capital formation, served to slow down monetary growth. The combined effect of these developments was to bring about a certain levelling-off in the annual growth rate of M3 at 2%.

Declining demand for highly liquid M3 components

Among the components of M3, only the highly liquid sub-aggregate M1 experienced a decline. While the demand for cash during the reporting period was up significantly on the quarter, this growth was nonetheless dominated by developments in sight deposits which took a downward turn for the first time since the second quarter of 2008. To a great extent, the declining attractiveness of overnight deposits is likely attributable to the widening differential between the virtually unchanged rate of interest applying to this kind of deposit and the rate for time deposits which went up again during the reporting quarter. Overall, at just under -½%, the seasonally-adjusted and annualised three-month rate for M1 fell to its lowest level since the second quarter of 2008. In seasonally adjusted and annualised terms, the growth rate of short-term deposits rose considerably by 3½%. Even so, this was less buoyant than one quarter earlier.

Sizeable inflows to marketable instruments

By contrast, in seasonally adjusted and annualised terms, the three-month growth rate for marketable instruments amounted to 11%, and was thus higher than at any time since the end of 2007. This was in part due to the fact that banks returned to settling more transactions through central counterparties which in turn led to a sharp increase in the number of repo transactions. Another causal factor was the strong inflows for short-term bank debt securities, also in connection with the measures adopted by individual euro-area countries to stabilise their banking systems.

Moderate increase in lending to the domestic private sector

As regards the counterparts of M3, loans to the domestic private sector during the reporting quarter expanded at a seasonally adjusted and annualised three-month rate of just over 2%. The pace of growth was somewhat slower than in the previous quarter which recorded an increase of just over 2½%. As in the preceding quarter, this increase was mainly attributable to developments in lending to the non-financial private sector. Broken down by sector, growth was due in equal measure to an increase in loans to non-financial corporations and to households. At 2%, the seasonally adjusted and annualised increase in loans to households was well below the level recorded for the previous quarter, which stood at just under 4½%. This was largely driven by the marked decline in loans for house purchase, which constitute the majority component of household borrowing. Lending to non-financial corporations likewise expanded at a somewhat slower pace in the reporting quarter. As in the previous quarter, lending in this sector was focused on short and long-term maturities while medium-term loans (with a maturity of over one and up to five years) again shrank, this time by a significant margin. Conversely, the extent of loans to financial corporations between April and June 2011 remained virtually unchanged.

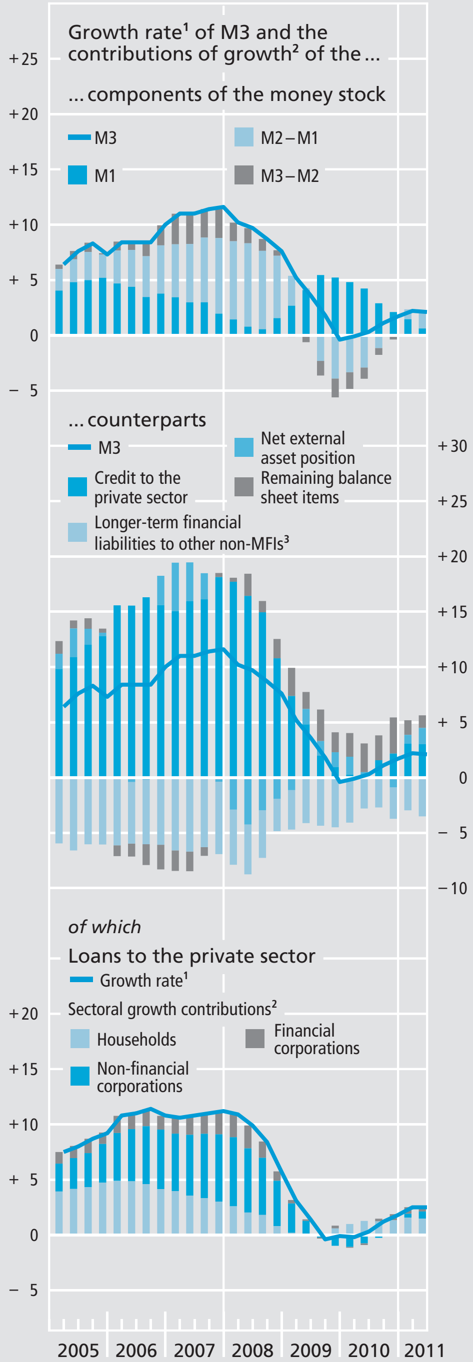
Drop in loans to general government

In the quarter under review, the significant inflows of loans to the domestic private sector were once again accompanied by a considerable drop in lending to general government, with the effect that, overall, loans to domestic non-banks barely registered any growth. In contrast to the situation in the previous quarter, the decline in lending to the public sector in the April to June period was solely the result of a reduction in unsecuritised lending in this segment. At the same time, there was a discernible increase in the central governments' deposits (which are not part of the monetary aggregate M3), which broadly dampened the M3 growth seen in the second quarter of 2011.

As was the case one quarter previously, the net external assets of the euro-area MFI sector rose considerably, which, taken in isolation, had an expansionary effect on monetary growth. This

Components and counterparts of the money stock in the euro area

Seasonally adjusted, quarterly



1 In percent, 12-month flows. — 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 Q1	2011 Q2
Deposits of domestic non-MFIs 1		
Overnight	4.7	7.6
With agreed maturities		
of up to 2 years	18.2	19.3
of over 2 years	– 4.0	– 2.2
Redeemable at notice		
of up to 3 months	3.6	– 1.3
of over 3 months	– 0.4	0.4
Lending		
to domestic enterprises and households		
Loans	1.9	14.1
of which to households 2	3.0	2.7
to non-financial corporations 3	10.9	– 1.7
Securities	– 0.1	– 5.1
to domestic general government		
Loans	– 17.2	– 23.8
Securities	– 7.3	– 2.1

* 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 Including non-financial quasi-corporations.

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Marked increase in net external position along with significant monetary capital formation

arose from a discernible increase in external assets combined with an almost unchanged level of external liabilities. However, this positive effect, was again restrained by significant monetary capital formation which was primarily driven by strong capital formation and accumulation of reserves along with a sharp increase in long-term bank debt securities (with a maturity of over two years).

Continued slight upside risks to price stability from a monetary perspective

The pick-up in the pace of underlying monetary expansion that was observed in the past few quarters lost steam in the second quarter. Nevertheless, on the whole, the inflation risk indicators derived from monetary data continue to point to upside risks to price stability over the monetary policy horizon. However, the high degree of uncertainty associated with these indicators at present should not be overlooked here.

German banks' deposit and lending business with domestic customers

Renewed strong inflows for short-term time deposits

At a seasonally adjusted and annualised growth rate of 3½% compared with just over 3% in the previous quarter, the moderate accumulation of deposits with German banks continued in the second quarter of 2011. This increase mainly related to short-term deposits, in particular time deposits with an agreed maturity of up to two years, which saw strong inflows. By contrast, short-term savings deposits were reduced slightly. This development is, not least, probably attributable to the fact that the interest rate advantage of short-term time deposits over other forms of investment of similar maturities widened once more during the second quarter.

Slowdown in reduction of longer-term deposit types

By contrast, domestic customers' longer-term deposits with German credit institutions shrank somewhat on balance, as was also the case one quarter earlier. However, the second-quarter reduction in time deposits with an agreed maturity of over two years was much smaller in size than that seen in the first quarter. As in the preceding three quarters, the outflows from this deposit category were mainly the product of portfolio investment decisions by financial corporations, with households again exhibiting a strong demand for this investment form. Longer-term savings deposits also experienced some growth, albeit of a modest kind. This may well be attributable to the fact that, during the reporting quarter, banks further enhanced the attractiveness of the rates of interest on this type of bank deposits while, in the same time period, capital market yields fell by a considerable margin owing to safe-haven effects.

Further decline in banks' lending to domestic non-banks

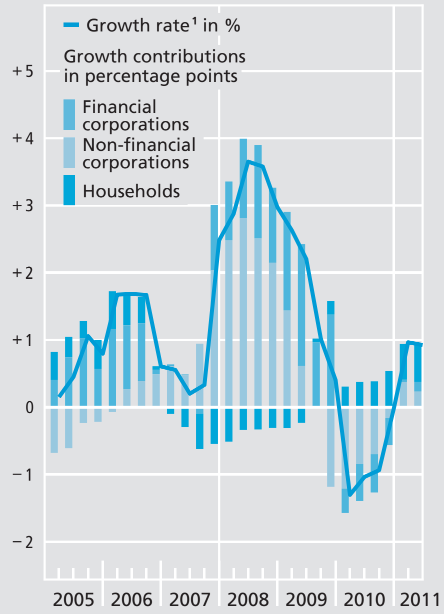
During the reporting period, German banks' lending to non-banks decreased again to record a seasonally adjusted and annualised three-month rate of -2%. As in the previous quarter, this development was largely driven by the decline in lending to general government while lending to the domestic private sector developed positively. This said, the increase in the latter compared with the figure recorded at the end of the previous quarter was very much the result of lending to financial corporations, mostly in the form of interbank transactions which were settled through a central counterparty and therefore did not entail any increased provision of credit to the non-financial private sector.

Medium-term lending to non-financial corporations main focus of reductions

By contrast, unlike in the euro area as a whole, the period under review saw a halt to German banks' expanded lending to domestic non-financial corporations, which had occurred on a very large scale in the winter months. If loans to enterprises are broken down by maturity, the slight decline compared with the previous quarter's final result is shown to be the product of a sharp drop in lending over the medium-term horizon. Although curbed lending in this segment was evident throughout the euro area, short-term lending at this level rose much more sharply. This contrasts with Germany where this type of lending, which had expanded by a significant margin in the previous quarter, grew only fractionally. The aggregate picture, however, masks extremely

Loans of German banks to selected domestic sectors

Seasonally adjusted, quarterly



1 Year-on-year rate of change.

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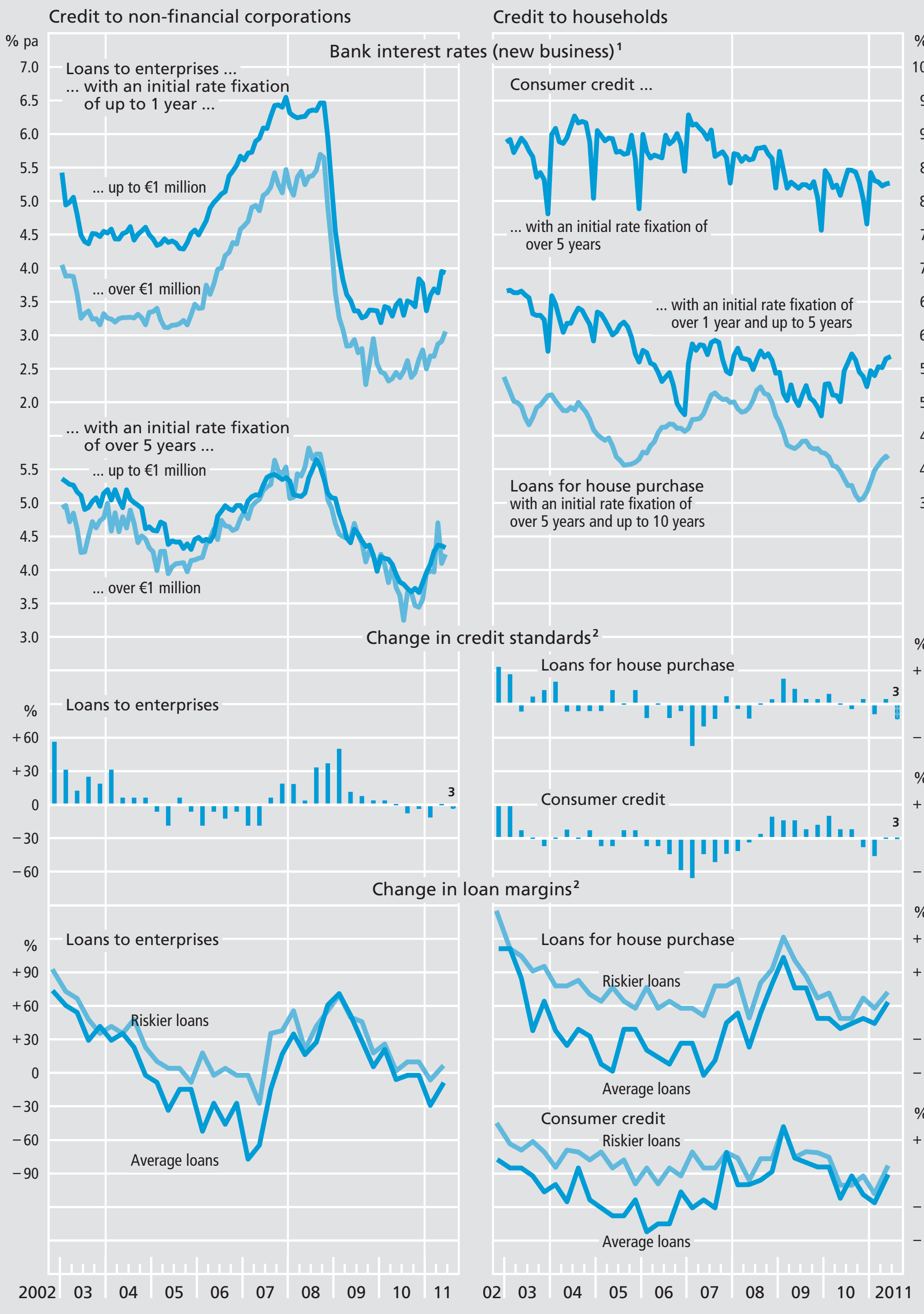
mixed developments in the course of the quarter and between bank groups. For instance, the decline in question is largely attributable to a marked curb in lending on the part of the Landesbanken in April, which had the effect of obscuring the increased growth in lending by savings banks during the quarter. Overall, at just over ½%, the annual growth rate of loans to non-financial corporations was somewhat down on the quarter but it still remained positive.

Loans for house purchase rise again.

While unsecuritised loans to households continued along the path of expansion which commenced in early 2009, the seasonally adjusted and annualised quarter-on-quarter increase in growth came in at just over ½% and was thus somewhat below the results for the two preceding quarters. The noticeable decline

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 Q3.

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in consumer credit growth was more than offset by a renewed increase in lending for house purchase. The interest rates on loans for house purchase no longer stood at the decidedly low level seen in 2010, nevertheless they remained favourable in a long-term comparison.

Lending policies in Germany unchanged

According to the results of the latest round of the Bank Lending Survey (BLS), participating German banks did not make further changes to their lending policies in the second quarter of 2011 after reporting perceptible easing a quarter earlier. For instance, credit standards and conditions for lending to both enterprises and households remained broadly constant. The margins on loans to borrowers of average quality were narrowed again somewhat, though to a lesser extent than one quarter previously. At the same time, they widened for riskier borrowers, in particular on private real estate loans. The participating institutions assume that credit standards for small and medium-sized enterprises and for loans to households for house purchase will ease somewhat in the third quarter, whereas they do not expect any adjustment with respect to other surveyed types of lending.

Further marked increase in demand

Parallel to this, the surveyed banks observed a clear increase in demand for loans to the private sector. As in the previous quarter, with regard to enterprises this increase was mainly driven by the financing needs for fixed assets and, on a smaller scale, for inventories and working capital. In the case of households, the improvement in consumer confidence played a crucial role.

Euro-area credit standards continued to tighten, however

Compared with the results for Germany, lending conditions in the euro area as a whole in the second quarter of 2011 again became more restrictive. The European banks cited not only cyclical but, given the ongoing sovereign debt crisis, also – and primarily – bank-related factors as reasons for this development.

Access to wholesale funding broadly unchanged

The second-quarter BLS once again contained a supplementary question on the impact of the financial and sovereign debt crisis on banks' refinancing conditions and, for the first time, another two questions about banks' planned and actual adjustments in line with the "Basel III" requirements. The German institutions stated that, in broad terms, their access to wholesale funding saw little change whereas the overall sample of euro-area banks reported a certain deterioration compared with the preceding quarter.

Response to Basel III: topping up of equity by retaining profits

In response to questions concerning Basel III, both German and European banks declared that they had strengthened their equity position in the first half of the year, mainly by retaining profits. Moreover, the decrease in risk-weighted assets as part of the realisation of changes planned by the BCBS was also of key importance to the euro area as a whole. Overall, the surveyed institutions expressed their intention to respond to the stricter regulations in a similar fashion in the second half of the year and in 2012.

Bank loans more expensive in overall terms

As in the previous quarter, the reporting institutions in Germany recorded an increase in lending rates in the second quarter of 2011. Unlike in the first quarter, this development was most pronounced for shorter-term rate fixation periods. However, longer-term loans for house purchase also became more expensive compared with the previous quarter, albeit to a somewhat smaller degree.[2] Long-term lending to non-financial enterprises was likewise more costly, amounting to 4.2% for large-scale loans and 4.3% for those of a smaller volume. All in all, movements in bank lending rates were in line with the interest rates paid on the money and capital markets.

2 Longer-term loans for house purchase encompass new lending with an initial rate fixation period of over five years up to ten years.