Monetary policy and banking business

Monetary policy and money market developments

ECB Governing Council cuts key interest rates to record low

At its monetary policy meeting at the beginning of July, the ECB Governing Council decided to lower the three key interest rates by ¼ percentage point. This decision reflected the Governing Council's view that the ongoing deterioration in the euro-area economic outlook had further dampened inflationary pressure over the policy-relevant horizon. In explaining the interest rate decision, the Governing Council also pointed out that its assessment was supported by the subdued underlying dynamics of monetary expansion. After the most recent cut, the main refinancing rate now lies at a record low of 0.75%. Bank balances in the deposit facility are earning, at 0%, no interest for the first time. For the monetary policy counterparties of the Eurosystem, the exceptional situation arises in which excess liquidity holdings in the deposit facility no longer earn more interest than excess reserves, which are held interest-free on current accounts with the national central banks. For this reason, the deposit facility was used more sparingly in the maintenance period ending on 7 August. Accordingly, institutions' deposits on current accounts with the Eurosystem rose.

Collateral framework expanded again

With regard to non-standard monetary policy measures, the Governing Council decided in the second quarter to continue full allotment for its refinancing operations until the beginning of 2013, and to make further changes to the requirements pertaining to collateral which Eurosystem central banks can accept for refinancing operations. For instance, at the meeting on 20 June, it was decided to lower the rating requirements and eligibility criteria for certain types of asset-backed securities (ABS) once again. To offset the higher risks resulting from the reduction of the rating threshold, this collateral will be subject to higher haircuts.

By contrast, the expiry on 25 July 2012 of the buy-back scheme for marketable debt instruments issued or guaranteed by Greece rendered these instruments ineligible for use as collateral in monetary policy operations for the time being, as they do not comply with the Eurosystem's rating threshold for marketable assets. However, the Greek financial sector is still being provided with ample emergency liquidity assistance via the Greek central bank.

Towards the end of the reporting period, liquidity flows to countries with a high credit rating decelerated somewhat overall compared with the spring. Nonetheless, Spain in particular continued to suffer constant outflows of liquidity, which the Eurosystem offset by increasing its liquidity provision. Inflows of liquidity to Germany, reflected in its TARGET2 balance, virtually came to a standstill. At the end of July, TARGET2 claims amounted to just under €730 billion.

Prospect of further non-standard measures

No further non-standard measures were adopted at the Governing Council's last meeting on 2 August; however, at the subsequent press conference, ECB President Draghi presented the prospect of expanding these measures substantially. In particular, the Governing Council would, under certain conditions, support a new, possibly extensive government bond purchase programme in order to eliminate what it considers to be severe distortions in the price formation process on these markets. Moreover, the activation of an EFSF/ESM programme for the country in question would be the main precondition for any such interventions by the Eurosystem. The Eurosystem's purchase programme is to focus on the shorter end of the yield curve. Its volume could be unlimited and should in any event be sufficient to achieve the programme's objectives. The Eurosystem's committees are to prepare the details of the programme and the Governing Council's decision. The Bundesbank remains of the opin-

Money market management and liquidity needs

During the three reserve maintenance periods from 11 April to 10 July 2012, euro-area credit institutions' need for central bank liquidity determined by autonomous liquidity factors rose by €88.6 billion in net terms. This increase was primarily due to the sum of changes in net foreign assets and other factors which, taken together, eliminate valuation effects with no impact on liquidity. The amount in question declined by a total of €74.8 billion in the period under review, thus increasing the need for central bank liquidity. Moreover, a net increase of €21.3 billion in the volume of banknotes in circulation across the three maintenance periods under review also served to amplify the liquidity-absorbing effect. By contrast, the opposite effect was induced by general government deposits which, from the perspective of period averages, went down by €7.5 billion in liquidity-providing terms. In addition to the development of autonomous factors, the minimum reserve requirement went up by €1.6 billion in net terms over the three reserve periods, thus increasing the need for central bank liquidity.

In the period under review, 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). This allowed the Eurosystem to continue to meet credit institutions' demand for central bank liquidity to the full amount. At its meeting on 6 June 2012, the Governing Council of the ECB decided to continue this allotment policy both in its main and longer-term refinancing operations at least until the end of the December 2012-January 2013 maintenance period. As part of this policy, the three-month tenders conducted prior to this date would in each case be allotted at the fixed rate corresponding to the average rate of the main refinancing operations conducted over the life of the respective operation.

As a result of the very high bids and allotments recorded for the two three-year tenders of December 2011 and the end of February 2012 (which entailed a total bid and allotted amount of around €1,019 billion), credit institutions in the euro area had so much central bank liquidity at their disposal that, for this reason alone, it was possible to meet the needs from autonomous factors and the minimum reserve requirement on each day of the period under review. Notwithstanding this fact, the volume of main refinancing operations went up by around €104 billion in net terms during this period, thus mirroring the increase in autonomous factors. Parallel to this, there was a decline in the corresponding volume of longer-term refinancing operations of around €18 billion. Average recourse to the deposit facility in the individual maintenance periods during the period under review consequently remained virtually unchanged, with all three period averages standing at €771 billion. During the three periods under review, recourse to the marginal lending facility averaged €1.0 billion, €1.6 billion and €1.8 billion respectively, thus falling below the average of all the preceding periods since the end of 2011. Owing to the high levels of excess liquidity, the overnight interest rates continued to be oriented to the deposit facility rate.

Between 11 April and 10 July 2012, no purchases were initiated by the Eurosystem under the Securities Markets Programme (SMP). Instead, even if revaluations are included, maturing issues caused the Eurosystem's holdings of SMP securities to deplete by around €2.8 billion to total €211.3 billion. As usual, weekly liquidity-absorbing fine-tuning operations equivalent to the volume of SMP holdings were conducted. Credit institutions showed a keen interest in these tenders, leading to consistent allotment rates of 0.26% in each of the three periods under review and therefore a spread compared to the deposit facility rate of just 1 basis point. During the period under review, the volume of securities purchased under the first Covered Bond Purchase Programme (CBPP) declined by around €1.0 billion to €55.9 billion as a result of maturing covered bonds and revaluations. Conversely, the balance sheet holdings of securities purchased under the purchase programme CBPP2 rose by €4.5 billion to €14.1 billion during the same period.

As in the previous period, the April-May 2012 maintenance period was characterised by the extremely comfortable liquidity conditions which had prevailed ever since the allotment of the second three-year tender at the end of February 2012. The outstanding tender volume (excluding liquidity-absorbing fine-tuning operations) averaged €1,136 billion over the period and was thus almost unchanged compared with its level at the same time one period earlier (€1,150 billion). At an average of €47 billion, the main refinancing operation again accounted for no more than a small part of this amount. The resulting very high level of excess liquidity – with liquidity needs from autonomous factors and the minimum reserve requirement standing at an average of around €427 billion over the period – translated not just into extensive use of the deposit facility but also persisting low overnight rates. In the reserve period in question, EONIA consistently averaged 0.34% and was thus 66 basis points below the main refinancing rate (previous period's figure: 65 basis points below the key interest rate). However, secured overnight money on Eurex Repo's Euro GC Pooling (ECB basket) was traded at an even lower rate which averaged 0.25%, making it equal to the deposit facility rate (as in the previous period). Averaging around €28 billion, the relatively low EONIA turnover showed little change in comparison to the previous period but still fell below the annual average of 2011 (around €33 billion). The corresponding secured overnight turnover of the GC Pooling trading platform went up slightly on average over the period to stand at €7.0 billion (compared with €6.8 billion in the previous period), but still remained well below the previous year's average of €12.6 billion.

The developments observed in the previous period continued in the May-June 2012 maintenance period. The more than ample liquidity supply continued to generate high recourse to the deposit facility and low overnight rates. Towards the end of the maintenance period, the volume of main refinancing operations saw a clear upturn after a number of Greek banks were recapitalised and readmitted as counterparties to the Eurosystem's monetary policy operations. Overnight rates remained quite stable, averaging 0.33% over the period for EONIA and 0.25% in the case of GC Pooling. This contrasted with the underlying turnover, which saw a decline. During the maintenance period, EONIA turnover fell to an average level of around €21 billion, about €7 billion below the figure recorded one period earlier. GC Pooling's overnight turnover (ECB basket) likewise dropped to €5.8 billion.

In the June-July 2012 maintenance period there was a marked increase in liquidity needs from autonomous factors and the minimum reserve requirements (averaging

Factors determining bank liquidity[1]

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

Item	2012		
	11 April to 8 May	9 May to 12 June	13 June to 10 July
I Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors			
1 Banknotes in circulation (increase: –)	– 1.5	– 8.1	– 11.7
2 Government deposits with the Eurosystem (increase: –)	+ 9.2	+ 19.3	– 21.0
3 Net foreign assets[2]	– 8.3	– 2.5	+ 9.9
4 Other factors[2]	+ 15.2	– 4.3	– 84.8
Total	+ 14.6	+ 4.4	– 107.6
II Monetary policy operations of the Eurosystem			
1 Open market operations			
(a) Main refinancing operations	– 9.4	+ 11.1	+ 102.6
(b) Longer-term refinancing operations	– 4.7	– 17.7	+ 3.9
(c) Other operations	+ 2.5	+ 1.0	+ 1.5
2 Standing facilities			
(a) Marginal lending facility	– 2.0	+ 0.6	+ 0.2
(b) Deposit facility (increase: –)	– 0.1	+ 0.6	+ 0.2
Total	– 13.7	– 4.4	+ 108.4
III Change in credit institutions' current accounts (I + II)	+ 0.9	+ 0.3	+ 0.7
IV Change in the minimum reserve requirement (increase: –)	+ 0.1	– 1.4	– 0.3

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.
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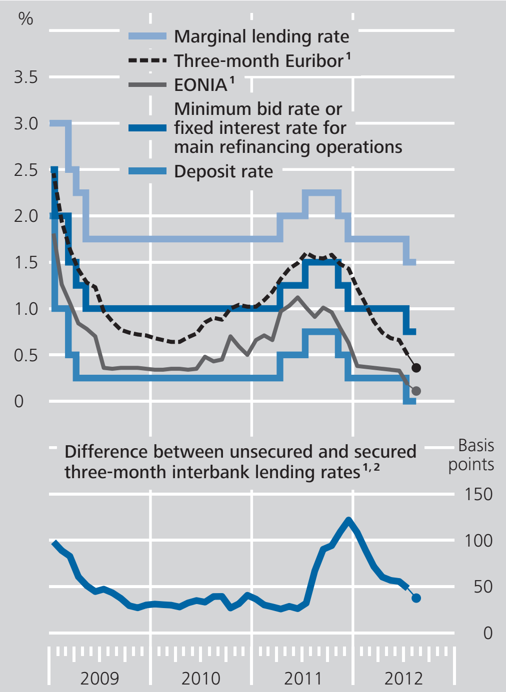
€532 billion compared with €424 billion in the previous period), accompanied by a higher level of participation in the main tenders. Demand in the main refinancing operations rose to peak at €180 billion at the end of June 2012 after occasionally hovering between €30 billion and €40 billion in the two preceding periods. This caused the outstanding volume of liquidity-providing tender operations to increase to €1,236 billion on average and the share of main refinancing operations in this total figure to swell to an average level of 13% after accounting for 5% of the previous period's figure (€1,129 billion). During the period in question, EONIA virtually levelled off at 0.33%. It was only at the half-year point that the reference rate went up by 5 basis points, which reflected a typical pattern, albeit to a far lesser extent (compared with the increase of 72 basis points recorded at half-year end in 2011). With respect to secured overnight money trading on the GC Pooling platform, there was somewhat increased volatility as the period progressed; the volume-weighted rate went up by as little as 3 basis points on the last day of the period at half-year end. However, the period average once again stood at 0.25%. As regards overnight turnover, the picture was mixed. While the EONIA turnover increased to average around €25 billion across the period, the corresponding secured turnover traded on GC pooling once again contracted slightly (€5.2 billion).

Money market interest rates in the euro area



1 Monthly averages. **2** Three-month Euribor less three-month Eurepo. • Average 1 to 15 August 2012.
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ion that a critical view should be taken, in particular, of government bond purchases by the Eurosystem as they entail, not least, substantial stability policy risks. It is the responsibility of fiscal policy makers and of the governments and parliaments of the euro-area countries to decide whether the mutualisation of solvency risks should perhaps be extended even further; such steps should not be taken via central bank balance sheets.

Securities holdings from monetary policy programmes unchanged on balance

Notwithstanding the discussion on further non-standard measures, the Eurosystem's securities holdings within the scope of the Securities Markets Programme fell slightly, as in the previous reporting period, to just over €211 billion. This was because no further transactions had been carried out by the Eurosystem since March 2011, and because matured paper had been redeemed. So far, a total of currently €14.8 billion has been accumulated by the Eurosystem under the second covered bond purchase programme (CBPP2). In parallel to this, debt instruments bought under the first covered bond purchase programme matured.

After a further strong rise in the refinancing volume in the previous quarter as a result of the second very long-term refinancing operation with a maturity of three years, the banking system's surplus liquidity – measured in terms of average recourse to the deposit facility plus excess reserves on current accounts –, at around €747 billion of late, remained at a very high level on average over the maintenance period running from 11 July to 7 August 2012.

Unsecured money market rates still declining after reduction in key interest rates

The reduction in the key interest rates passed on 5 July is reflected almost entirely in the unsecured money market rates. The unsecured overnight rate EONIA initially stagnated in a sideways movement at around 0.33% from the beginning of the second quarter, and promptly fell to currently around 0.11% once the key interest rate decision had taken effect on 11 July. The spread between EONIA and the rate on the deposit facility therefore rose only slightly. The decline in longer-term unsecured money market rates since the beginning of the year virtually came to a standstill in the course of the second quarter. However, it did pick up again at a considerably higher pace after the ECB Governing Council's interest rate decision. For unsecured three-month money, banks are currently reporting interest rates of around 0.34%. This represents a decline of just over 30 bp compared with the end of June. Rates of around -0.01% are currently being quoted for money market operations backed by the best collateral. These rates are thus merely around 10 basis points lower than they were before the key interest rate cut. In line with this, compared with the beginning of the second quarter there was another sharp fall of around 27 basis points in the spread between unsecured and secured money market rates with a maturity of three months to around 35 basis points of late.

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
11.04.12	MRO (FRT)	7	55.4	758.4	1.00	100.00	–	1.00	82
11.04.12	FTO (–)	7	– 214.0	–	0.26	77.06	0.26	1.71	66
11.04.12	S-LTRO (FRT)	28	11.4	–	1.00	100.00	–	1.00	20
18.04.12	MRO (FRT)	7	51.8	908.8	1.00	100.00	–	1.00	85
18.04.12	FTO (–)	7	– 214.0	–	0.26	61.77	0.26	2.05	75
25.04.12	MRO (FRT)	7	46.4	904.4	1.00	100.00	–	1.00	82
25.04.12	FTO (–)	7	– 214.0	–	0.26	63.79	0.26	1.92	70
26.04.12	LTRO (FRT)	91	21.3	–	4 0.96	100.00	–	1.00	39
02.05.12	MRO (FRT)	7	34.4	1038.9	1.00	100.00	–	1.00	77
02.05.12	FTO (–)	7	– 214.0	–	0.26	62.48	0.26	1.82	58
09.05.12	MRO (FRT)	7	39.3	787.8	1.00	100.00	–	1.00	80
09.05.12	FTO (–)	7	– 214.0	–	0.26	59.06	0.26	2.06	74
09.05.12	S-LTRO (FRT)	35	13.0	–	1.00	100.00	–	1.00	20
16.05.12	MRO (FRT)	7	43.0	949.0	1.00	100.00	–	1.00	84
16.05.12	FTO (–)	7	– 214.0	–	0.26	54.19	0.26	2.19	75
23.05.12	MRO (FRT)	7	37.9	944.9	1.00	100.00	–	1.00	84
23.05.12	FTO (–)	7	– 212.0	–	0.26	54.99	0.26	2.22	70
30.05.12	MRO (FRT)	7	51.2	897.2	1.00	100.00	–	1.00	87
30.05.12	FTO (–)	7	– 212.0	–	0.26	61.14	0.26	1.98	66
31.05.12	LTRO (FRT)	91	8.3	–	4 ...	100.00	–	1.00	33
06.06.12	MRO (FRT)	7	119.4	888.9	1.00	100.00	–	1.00	96
06.06.12	FTO (–)	7	– 212.0	–	0.26	61.48	0.26	1.98	71
13.06.12	MRO (FRT)	7	131.7	774.2	1.00	100.00	–	1.00	94
13.06.12	FTO (–)	7	– 212.0	–	0.26	82.09	0.26	2.06	72
13.06.12	S-LTRO (FRT)	35	18.9	–	1.00	100.00	–	1.00	21
20.06.12	MRO (FRT)	7	167.3	902.3	1.00	100.00	–	1.00	101
20.06.12	FTO (–)	7	– 210.5	–	0.26	65.88	0.26	1.84	66
27.06.12	MRO (FRT)	7	180.4	890.9	1.00	100.00	–	1.00	105
27.06.12	FTO (–)	7	– 210.5	–	0.26	78.83	0.26	1.37	62
28.06.12	LTRO (FRT)	91	26.3	–	4 ...	100.00	–	1.00	50
04.07.12	MRO (FRT)	7	163.6	909.6	1.00	100.00	–	1.00	92
04.07.12	FTO (–)	7	– 210.5	–	0.26	62.45	0.26	1.89	73

* For more information on the Eurosystem's operations from 18 January 2012 to 10 April 2012, see Deutsche Bundesbank, Monthly Report, May 2012, p 30. **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 (may be rounded to two decimal places in the table).
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Monetary developments in the euro area

Monetary developments remain moderate

The development of the broad monetary aggregate M3 has been unusually volatile since the sovereign debt crisis worsened again in summer 2011. The growth of the seasonally adjusted and annualised three-month rate slowed down in the reporting quarter to 2½% at the end of June, after just over 7½% at the end of March and just over -3% at the end of December. Disregarding the temporary effects of the financial crisis and the considerable provision of liquidity via the three-year refinancing operations conducted as non-standard monetary policy measures in December 2011 and February 2012, the increase in M3 is still to be regarded as moderate. The monetary expansion in the spring months was supported both by further portfolio shifts by non-banks in favour of sight deposits and by inflows to repo transactions. By contrast, bank lending to private non-banks declined clearly. Hence, the decoupling of monetary growth from weak lending to the domestic private sector since the beginning of the year continued. As a result, the annual growth rate of these loans (adjusted for loan sales and securitisation) fell from 1.2% to 0.3% in the second quarter of 2012, while the annual

Consolidated balance sheet of the MFI sector in the euro area*

Changes in € billion, seasonally adjusted

Assets	2012 Q2	2012 Q1	Liabilities	2012 Q2	2012 Q1
Loans to non-MFIs in the euro area	– 9.3	19.8	Central government deposits	– 24.7	10.2
of which			Monetary aggregate M3	56.3	182.2
to general government	24.8	– 8.7	*of which components*		
to private non-MFIs[1]	– 34.1	28.6	Currency in circulation and overnight deposits (M1)	36.7	65.8
Lending in the form of securities to non-MFIs in the euro area	– 36.7	140.5	Other shorter-term bank deposits (M2-M1)	0.0	74.0
of which			Marketable instruments (M3-M2)	19.6	42.5
to general government	18.3	108.1	Monetary capital	– 71.4	– 29.9
to private non-MFIs	– 55.1	32.5			
Net external assets	– 23.2	– 15.3			
Other counterparts of M3	29.5	17.4			

* Changes for statistical reasons eliminated. 1 Adjusted for loan sales and securitisation.
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growth rate of M3 remained at 3.2% in the reporting period.

Perceptible increase in sight deposits and marketable instruments

Two-thirds of the second-quarter increase in M3 stemmed from the narrow monetary aggregate M1, even though its seasonally adjusted and annualised three-month rate dropped from 5½% at the end of the first quarter to 3% at the end of the second quarter. The biggest contribution to growth was made by considerable inflows to sight deposits of households and non-financial corporations. The reasons behind these inflows were portfolio shifts away from short-term time deposits and financial instruments outside M3. The volume of these shifts was sufficient to more than offset the strong reduction in sight deposits through other financial intermediaries (OFIs). The remaining third of the rise in M3 was a result of the positive development in marketable financial instruments (M3-M2), which was mainly attributable to a noticeable increase in repo transactions. For the most part, these transactions comprise secured interbank transactions settled through central counterparties, which do not represent transactions by the money-holding sector.

Stagnation of other short-term deposits

The build-up of other short-term bank deposits (M2-M1), which had mostly produced a discernibly positive effect on the growth of the monetary aggregate in the preceding quarters, came to a halt in the second quarter. The financing conditions characterised by uncertainty and low interest rates led non-financial corporations and households in particular to shift short-term time deposits within M3 towards more liquid sight deposits and short-term savings deposits. This, in turn, caused the seasonally adjusted and annualised three-month rate (M2-M1) to stagnate at 0% at the end of June, compared with 8% at the end of March.

Lending in the form of securities to private sector declining …

The increase in M3 contrasted with a broad-based decline in bank lending to the euro-area private sector in the second quarter. Commercial banks shed a large amount of privately issued shares and other securities between April and June, after they had accumulated these to a marked extent in the previous quarter as a result of the extensive provision of liquidity via the three-year refinancing operations. The reduction in fixed income securities was particularly pronounced, but resulted mainly from the expiry of banks' retained loan securitisations, and so did not represent an overall slump in demand for securities.

… loans to financial corporations record outflows, too

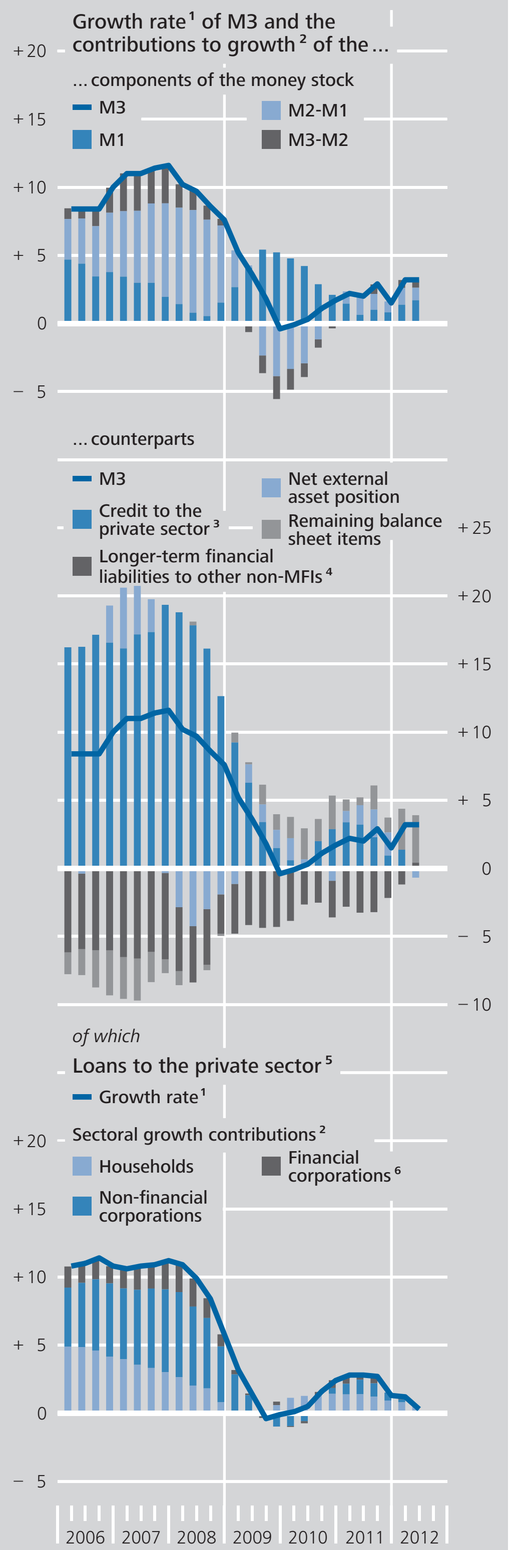
Loans to the domestic private sector (adjusted for loan sales and securitisation) likewise recorded a distinct outflow in the second quarter. Their seasonally adjusted and annualised three-month rate fell from 1% at the end of March to just over -1% at the end of June. This development was triggered, in particular, by loans to financial corporations, which are often indirect interbank transactions such as reverse repos and do not represent any additional outflow of funds from the private non-bank sector *per se*. Nor did loans to non-financial corporations and households strengthen monetary growth substantially, however; instead, they stagnated and rose only marginally respectively in the second quarter. Nevertheless, lending patterns varied greatly within the euro area, with a rise recorded for member states which had retained their high credit rating and outflows for the countries which have been hit hardest by the debt crisis and are undergoing a substantial structural adjustment process.

Marginal increase in lending to households; stagnation in lending to non-financial corporations

The seasonally adjusted and annualised three-month rate of loans (adjusted for loan sales and securitisation) to euro-area households fell from 1½% at the end of March to just under ½% at the end of June. As in the previous quarter, the increase was attributable to loans for house purchase, with the consistently favourable financing conditions probably playing a part. By contrast, consumer credit continued to decline slightly. The three-month rate of loans (adjusted for loan sales and securitisation) to non-financial corporations left negative territory after two quarters and rose from -½% at the end of March to 0% at the end of June. This was mainly attributable to the short-term maturity range whereas, on balance, long-term loans to non-financial corporations were down for the first time since the time series began in 2003. On the whole, the hope that ample central bank liquidity provided through the two three-year refinancing operations could support lending to the private sector has not been fulfilled thus far. Instead, bank lending appears to have been overshadowed, above all, by the economic downturn in the euro area, greater uncertainty among borrowers as well as balance sheet consolidations in some euro-area countries.

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** Adjusted for loan sales and securitisation. **4** Taken in isolation, an increase curbs M3 growth. **5** Adjusted for loan sales and securitisation from 2010 Q1. **6** Non-monetary financial corporations.

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Moderate decline in the net external asset position

The development of the net external asset position of the euro-area MFI sector vis-à-vis non-residents also had *per se* a dampening effect on M3, the reduction of which gathered pace slightly compared with the previous quarter. This development was driven by a clear decrease in external claims, which was only partially compensated for by the simultaneous decline in external liabilities.

Further substantial reduction in monetary capital …

The growth of M3 was mainly supported by the substantial decline in the MFIs' longer-term financial liabilities vis-à-vis other sectors (monetary capital). Monetary capital, which had risen almost continuously from the beginning of the monetary union until well into 2011 – thereby exerting a dampening effect on monetary growth – has increasingly been recording outflows since autumn 2011. These outflows reached a temporary peak in the reporting quarter. While the accumulation of capital and reserves by MFIs persisted, longer-term time deposits posted a strong decline that stemmed mainly from financial corporations. This was primarily the result of a decline in banks' loan securitisation activities. Moreover, the current uncertainty in the financial markets and the resulting demand of institutional investors for liquid funds also played a role. In addition, the major reduction in long-term bank debt securities, which has been observed since autumn 2011, continued. This development reflects the private sector's persistent caution with regard to the long-term financing of the banking sector. Unlike in the previous quarters, however, the outflow was not partially offset by a countermovement in short-term bank debt securities in the reporting quarter.

… as well as a clear increase in loans to domestic general government

Another positive influence on monetary growth was exercised by the continued increase in MFIs' lending to general government, which – amidst some volatility – has expanded substantially since autumn 2008. The seasonally adjusted and annualised three-month rate fell from just over 13% (revised) at the end of March to 5½% at the end of June. However, this drop is mainly accounted for by the strong temporary effect that the three-year refinancing operations had on banks' demand for government bonds in certain euro-area countries in the first quarter. By contrast, lending to the public sector was up significantly compared with the previous quarters.

Underlying monetary growth still subdued

The underlying pace of monetary expansion remained subdued on the whole in the second quarter of 2012. Although portfolio shifts towards highly liquid assets and the continued rise in bank lending to domestic general government bolstered M3 growth, bank lending to the domestic private sector continued to weaken. Such a decoupling of monetary developments from private lending was last seen in the years 2001 to 2003, when extensive portfolio shifts towards M3 took place as a result of heightened uncertainty in the real economy and the geopolitical arena.

Money-based forecasts with no particular risks to price stability

Inflation forecasts on the basis of various monetary indicators (monetary aggregates, short-term deposits, loans) currently signal no particular risk to price stability for the next three years on average. However, the uncertainty associated with these forecasts remains high.

German banks' deposit and lending business with domestic customers

Accelerated growth in the deposit business of German banks

The deposit business of banks in Germany grew with even more momentum in the reporting quarter than in the winter months. The seasonally adjusted and annualised three-month rate climbed to 7%, thereby attaining a level last seen at the end of 2008. As in the preceding quarters, the increase was solely sustained by short-term types of investment, the interest rates on which did not lose as much of their appeal in relative terms, although they did fall slightly in the reporting quarter. As in the quarter before, growth was driven by sight deposits in particular, but short-term time and savings deposits saw substantial inflows again, too.

This was again countered by a considerable decline in longer-term types of investment. Hence, the portfolio shifts away from long-term towards shorter-term types of deposits continued through the spring quarter of 2012.

Reduction of longer-term deposits continues at somewhat slower pace

In the case of longer-term deposits, time deposits with a maturity of over two years once again fell significantly. The decline was brought on by further portfolio shifts by insurance companies and OFIs which, unlike in the previous quarters, were no longer compensated for by inflows of deposits from households. In contrast to the longer-term time deposits, the decrease in savings deposits with longer periods of notice slowed down markedly in the reporting quarter. Movements in this market segment are usually almost exclusively attributable to households' portfolio decisions.

Only slight increase in banks' lending to domestic non-banks

Unlike the deposit business, the lending business of German banks with domestic non-banks again increased only slightly in the second quarter of 2012 on balance. The (seasonally adjusted and annualised) increase of ½% over the previous quarter was exclusively supported by an expansion in loans to domestic general government. However, the increase in lending must also be seen in the context of restructuring measures in the banking sector, which led to transfers between the banking and government sector in June. By contrast, loans to general government declined in April and May. Lending to the private sector fell on balance in the second quarter, however, as the moderate increase in June was not sufficient to fully offset the considerable decline in April. The reduction applied both to loans and securitised lending to the domestic private sector, with the latter declining for the fifth consecutive quarter. The development of securitised loans in the reporting quarter was, however, also influenced by special factors. For instance, the major decline in April is connected to a change in tax law which has caused securities transactions that are regularly conducted between banks and financial corporations to lose their appeal.

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

Changes in € billion, seasonally adjusted

Item	2012 Q1	2012 Q2
Deposits of domestic non-MFIs 1		
Overnight	26.4	42.6
With agreed maturities		
of up to 2 years	10.5	11.4
of over 2 years	– 8.9	– 7.0
Redeemable at notice		
of up to 3 months	3.4	3.7
of over 3 months	– 3.2	– 0.8
Lending		
to domestic general government		
Loans	0.4	10.3
Securitised lending	3.2	1.0
to domestic enterprises and households		
Loans	4.6	– 2.6
of which to households 2	6.3	4.1
to non-financial corporations 3	5.2	5.1
Securitised lending	– 5.5	– 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** Corporations and quasi-corporations.

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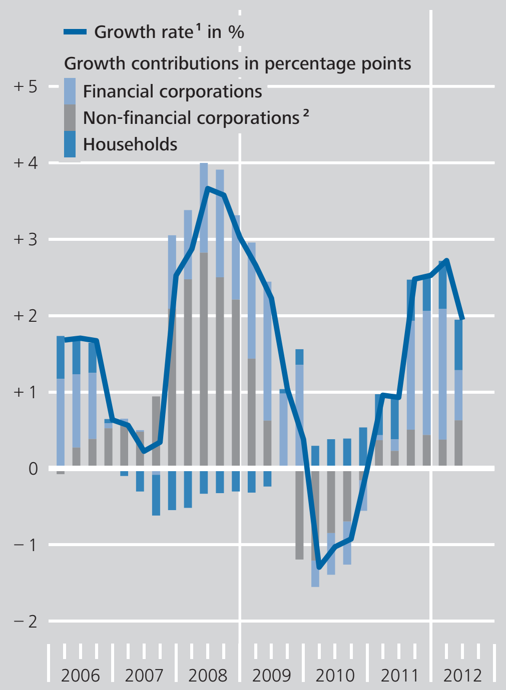
Significant expansion in loans to non-financial corporations

The decline in loans to the private sector was exclusively attributable to significantly reduced lending to financial corporations. These were mostly reverse repo transactions, the reduction of which does not in itself represent a classical withdrawal of funds for the private non-banking sector. However, the other two components (loans to non-financial corporations and loans to households) recorded increases, which could have been a result of the – again – more favourable financing conditions in the second quarter. In contrast to the developments in the euro area as a whole, loans to non-financial corporations in Germany were again considerably extended in the reporting quarter, with inflows covering all maturity segments. Landesbanken, savings banks and cooperative banks in particular contributed to this expansion. While the corresponding seasonally adjusted and annualised three-month rate – at 2½% – stabilised in the reporting quarter at the end-March level, the annual growth rate rose by one percentage point to 2% at the end of

Loans of German banks to selected sectors

Seasonally adjusted, end-of-quarter data



1 Year-on-year rate of change. **2** Non-financial corporations and quasi-corporations.
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June, with the end of a base effect also playing a role.

Discernible growth in loans to households

Besides loans to non-financial corporations, German banks also discernibly increased their loans to domestic households in the reporting quarter. Nevertheless, with a seasonally adjusted and annualised growth rate of just over 1%, lending to this sector grew somewhat less strongly than in the first three months of 2012. This was due to consumer credit, which declined somewhat between April and June 2012. By contrast, the growth of loans for house purchase accelerated again slightly from 1.5% at the end of March to 1.7% at the end of June (annualised values). In the case of loans to households, it was primarily savings banks, regional banks and cooperative banks that contributed to the growth, whereas mortgage banks and big banks scaled back their business in this area. As in the previous quarter, the 12-month rate of loans to households remained at 1.1%.

German banks' credit standards for corporations unchanged

According to the latest Bank Lending Survey results, credit standards for lending to non-financial corporations in Germany remained virtually unchanged in the second quarter of 2012.[1] A deterioration in sector-specific and firm-specific factors, along with higher costs of capital, counterbalanced banks' good liquidity situation. Credit conditions were more restrictive than one quarter before, especially with regard to margins. According to the survey respondents, large enterprises were hit harder by the tightened credit conditions than small and medium enterprises. At the same time, there was a fall in demand for loans to enterprises among the banks participating in the survey, whereas the more comprehensive banking statistics recorded an increase in lending to this sector.

Standards of private loans for house purchase slightly tighter, however

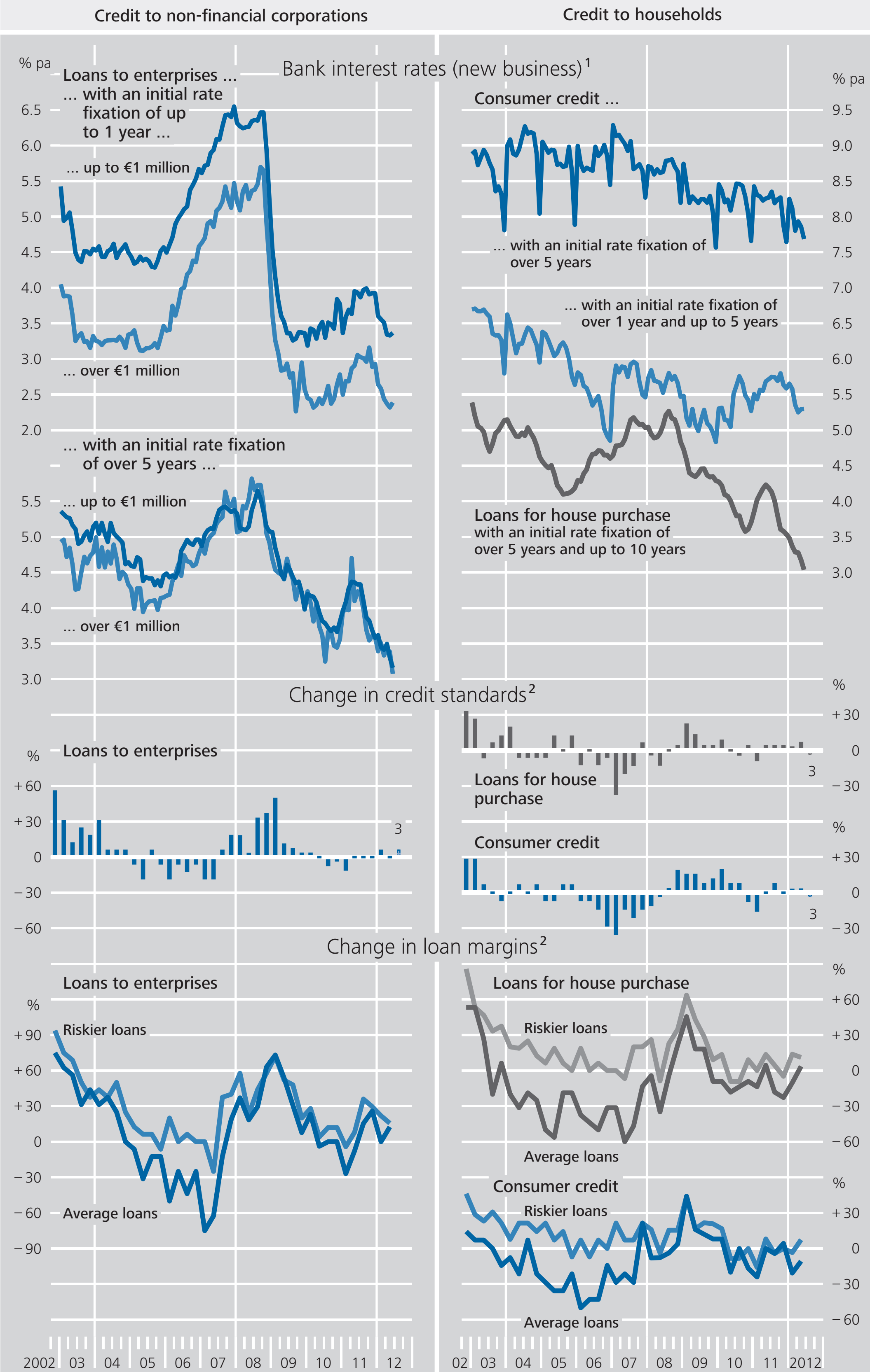
In addition, banks tightened their credit standards for private loans for house purchase slightly, but not for consumer credit. Credit conditions in both lines of business were adjusted only marginally. At the same time, the surveyed banks reported a sharp rise in demand for private loans for house purchase. This increase was again driven by the positive outlook in the housing market, low interest rates and robust consumer confidence. Demand for consumer credit, however, remained unchanged from the preceding quarter.

Tighter capital regime with clear impact on business policy

The July survey round was supplemented by several *ad hoc* questions on banks' funding conditions and the impact that the stricter capital regime and the sovereign debt crisis were having on lending. The institutions surveyed reported a perceptible deterioration in their long-term retail funding, whereas access to all other funding sources changed relatively little on the whole. By contrast, the European Banking Authority's provisions for large, international banks and the institutions' preparations for the stricter Basel III capital regime

1 The aggregate survey results for Germany may be found at http://www.bundesbank.de/Redaktion/EN/Standardartikel/Core_business_areas/Monetary_policy/volkswirtschaft_bank_lending_survey.html.

Banking conditions in Germany



1 According to harmonised MFI interest rate statistics. 2 According to the Bank Lending Survey, difference between the number of respondents reporting “tightened considerably” and “tightened somewhat” and the number of respondents reporting “eased somewhat” and “eased considerably” as a percentage of the responses given. 3 Expectations for 2012 Q3.

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had a considerable impact on institutions' business policy. Amongst other things, this led banks to make a marked reduction in their risk-weighted assets and an increase in their equity capital, particularly by retaining profits, in the first half of the year. By contrast, the surveyed banks expect the impact of the stricter provisions for risk-weighted assets to be limited in the second half of the year. On balance, one in four banks will continue to shed riskier loans, however. In addition, as in the first half of the year, banks are planning to strengthen their capital position by means of retained earnings. Moreover, lending to large enterprises in particular will be subject to tighter credit standards as a result of the stricter capital regime. By contrast, in the previous quarter – as in the preceding quarters –, the sovereign debt crisis had virtually no impact on German banks' funding situation or their credit standards.

Sovereign debt crisis has stronger influence on refinancing and credit supply policy of European banks

Credit standards in the euro area, on the other hand, were tightened again slightly. This was due not only to restrictive bank-related factors but also to a deterioration in the institutions' perception of risk. At the same time, demand fell further in all surveyed business lines. As was to be expected, the sovereign debt crisis had a stronger effect on the funding conditions of the banks in the Europe-wide sample. Respondents reported somewhat more difficult conditions across all surveyed markets and sources. Also more significant than in the German subsample was the impact of the stricter capital regime on risk-weighted assets. According to the surveyed banks, the latter were strongly reduced in the first six months of the year.

Bank interest rates in Germany down again

Under the influence of falling interest rates in the money and capital markets, the bank interest rates of the German reporting institutions decreased markedly again in the second quarter, in many segments reaching their lowest point since the start of the series in 2003. Correspondingly, long-term loans to enterprises were priced around 25 bp lower compared with the end of March. The weighted average of all new loan agreements was last recorded at 3.2% for small-volume and 3.1% for large-volume loans. Loans for house purchase with an interest rate fixation period of over ten years were likewise concluded at 3.2% – almost 30 bp below the March value. For long-term consumer credit, the reporting institutions demanded an average of 7.7% at the end of the reporting period. Some strong interest rate cuts were again made in deposits, too. This meant that longer-term time deposits in particular earned perceptibly lower rates of interest than just one quarter before.