

## Monetary policy and banking business

### Monetary policy and money market developments

*Key interest rates back to all-time low*

The clouding of the overall economic outlook in the euro area and its consequences for inflation prospects across the entire monetary union prompted the Governing Council of the ECB to completely reverse the interest rate hikes decided in April and July 2011 by cutting rates twice in the autumn. As a result of the key interest rates being lowered by 25 basis points at the beginning of both November and December, the main refinancing rate has been back at its historically low level of 1% since 14 December 2011. By keeping the corridor breadth unchanged at 150 basis points, the interest rate for recourse to the marginal lending facility has returned to 1¾%, with the interest rate on the deposit facility set at ¼%.

*Introduction of further non-standard measures in October and December 2011*

In addition, concern about the growing tensions in the financial markets potentially hampering the banking sector's lending to households and non-financial corporations caused the Governing Council of the ECB to introduce further non-standard monetary policy measures. Hence, at the beginning of October, it decided to launch a second covered bond purchase programme (CBPP2) to help resolve banks' longer-term funding problems. Under this programme, securities amounting to a total of €40 billion are to be purchased by the end of October 2012. Also at the beginning of October, the Council took the decision to offer two additional long-term refinancing operations with maturities of initially 12 and subsequently 13 months. The first of these two operations was carried out on 26 October 2011. At just under €57 billion, demand – and thus the allotment volume – was closer to the lower end of the forecast range.

As the crisis escalated further, in December the Governing Council of the ECB finally decided for the first time ever to provide central bank liquid-

ity in two LTROs with a maturity of three years. The operations will be conducted as fixed rate tender procedures with full allotment and are interest indexed. This means that banks are not charged a pre-defined interest rate but, upon maturity of the transaction, they are charged the average key interest rate over the term. The first three-year operation was carried out on 21 December 2011 (effectively replacing the 13-month tender announced in October). At €489.2 billion, the amount allotted in this operation reached a record high. However, this amount also includes €45.7 million that were shifted from the 12-month LTRO allotted in October. The second three-year operation is scheduled for 29 February 2012. In addition, a number of measures to extend the collateral framework were agreed at the beginning of December. Moreover, the reserve ratio was reduced from 2% to 1% with effect from 18 January 2012.

The significant deterioration of financial market conditions led to a renewed massive increase in banks' demand for liquidity from the Eurosystem in the fourth quarter. The sudden surge in the gross refinancing volume from €490 billion at the end of September to just under €700 billion at the end of December was mainly attributable to the substantial recourse to the first three-year LTRO. The excess liquidity in the banking system, which had already risen steadily in the preceding months, climbed to a new record high of €400 billion on average over the reserve period from 14 December 2011 to 17 January 2012. The two interest rate cuts as well as the increase in excess liquidity led to a fall in the overnight rate EONIA during the autumn from an average of 1.05% in the reserve period from 14 September to 11 October to 0.45% on average over the reserve period from 14 December to 17 January. As a consequence, the spread between EONIA and the rate on the deposit facility narrowed from 30 to 20 basis points.

*Growing excess liquidity puts more downward pressure on overnight rate*

## Money market management and liquidity needs

During the three reserve maintenance periods from 12 October 2011 to 17 January 2012, euro-area credit institutions' need for central bank liquidity as determined by autonomous liquidity factors rose by €13.4 billion in net terms. This development was mainly attributable to the total increase of €28.8 billion in the volume of banknotes in circulation during the period under review, which was mostly due to the usual seasonal increase around Christmas. Moreover, general government deposits with the Eurosystem worth an additional €17.7 billion net also had a liquidity-absorbing effect. The opposite effect was induced by the sum of changes in net foreign assets and other factors which, taken together, eliminate valuation effects with no impact on liquidity. This amount increased by a total of €33.1 billion in the period under review, thus reducing the need for central bank liquidity. Additional emergency liquidity assistance granted by some national central banks in the Eurosystem as well as a boost to foreign reserves contributed to this increase. The credit institutions in the Eurosystem were easily able to meet their minimum reserve requirements, which went up by €1.0 billion net in the period under review.

As 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 26), the volume of liquidity provided through the tender operations was determined exclusively by the demand from credit institutions in the euro area. As in the previous periods, in most cases demand significantly exceeded the calculated requirement arising from autonomous factors and the minimum reserve requirement. In the final quarter of 2011, the ECB Governing Council made several monetary policy decisions affecting money market management: on 6 October 2011, it decided to maintain full allotment until at least the beginning of July 2012. At the

same time, it announced that two one-year tenders would be conducted: one at the end of October and one at the end of December 2011. It also announced a new covered bond purchase programme (CBPP2). In addition to two interest rate reductions of 25 basis points each at the beginning of November and December 2011, which ultimately brought the rate down to 1%, on 8 December, the Governing Council decided to conduct two three-year tenders, one at the end of December 2011 (in place of the one-year tender) and one at the end of February 2012 with the option of early repayment after one year. It further decided to cut the reserve ratio from 2% to 1% as of 18 January 2012, to increase collateral availability and to discontinue the one-day liquidity-absorbing fine-tuning operations at the end of the reserve period as of the December 2011-January 2012 reserve maintenance period.

The liquidity provided through tenders increased sharply during the period under review owing, in particular, to the very high demand for liquidity of around €490 billion in the first three-year tender, conducted at the end of December 2011. The volume of longer-term refinancing operations increased over the three reserve periods by €254 billion, while the overall volume of main refinancing operations only decreased by €24 billion in the same period. This caused the proportion of longer-term refinancing operations in the outstanding tender volume (excluding liquidity-absorbing fine-tuning operations) to rise from 65% to 86% over the course of the observation period. Recourse to the deposit facility in the Eurosystem rose very sharply and, comparing period averages, increased by €231 billion in net terms over the three maintenance periods under review. At the same time, however, recourse to the marginal lending facility increased perceptibly from an average of €2.8 billion to €6.0 billion,

reflecting the ongoing segmentation of the money market.

The value of purchases effected under the CBPP2 between November 2011 and 17 January 2012 stood at €4.2 billion (given a 12-month target of €40 billion). In addition, with regard to the Securities Markets Programme (SMP), the amount outstanding – if matured securities are taken into account – increased by €52.8 billion to a total of €216.8 billion in the period under review. However, thanks to the continued weekly liquidity-absorbing fine-tuning operations, the inflow of liquidity generated by the SMP purchases was completely neutralised during the three observation maintenance periods, with just one small exception. During the same period, the balance sheet holdings of securities purchased under the first CBPP fell by €0.9 billion to €58.4 billion as a result of maturing covered bonds and revaluations.

The most important event during the October–November 2011 maintenance period was the allotment of the first of the two one-year tenders decided upon at the beginning of October 2011. However, credit institutions showed little interest in this tender; a total of €56.9 billion was demanded and allotted. At just under €17 billion, the resulting net supply of liquidity was also relatively modest because the credit institutions had reduced their volumes by just over €40 billion in the three-month tender which was renewed at the same time. Consequently, at €583 billion on average, the total outstanding tender volume (excluding liquidity-absorbing fine-tuning operations) recorded for this period was only slightly up from its level one period earlier (€567 billion). However, since the demand for liquidity from autonomous factors also sank by around €18 billion on average over the period, there was a noticeable rise in excess liquidity. This triggered a significant increase in recourse to the deposit facility in the Eurosystem, which climbed to an average of €205 billion compared with €169 billion in

the previous period. The more comfortable liquidity conditions also had an impact on overnight money. The fairly stable EONIA stood at 0.94% on average over the period and was thus 56 basis points below the main refinancing rate (previous period: -45 basis points). In the same period, lower rates were also recorded in secured overnight money trading on Eurex Repo's GC Pooling trading platform (ECB basket); on a volume-weighted average, the overnight rate was 0.85% on average, just under ten basis points below the EONIA. At €33.3 billion on average, EONIA turnover remained relatively low in this period (previous period: €32.6 billion), while secured overnight turnover on GC Pooling (ECB basket) declined slightly on average to €13.7 billion (previous period: €15.2 billion).

During the November–December 2011 maintenance period, demand in the main refinancing operations continued to grow despite the more comfortable liquidity conditions, averaging €238 billion across the period. The outstanding tender volume consequently rose to €627 billion on average while recourse to the deposit facility increased to €254 billion on average over the period. The EONIA did not fully mirror the reduction in the key interest rate (by 25 basis points to 1.25%) and stood at an average of 0.74% over the period, ie 51 basis points below the key interest rate. Parallel to this, there was a reduction in the spread between the EONIA and the volume-weighted average secured overnight rate on GC Pooling, which averaged 0.69%. At €31.4 billion (EONIA) and €15.0 billion (GC Pooling) respectively, the underlying overnight turnovers showed little change in comparison to the previous period.

The December 2011–January 2012 maintenance period, during which a new main refinancing rate of 1% prevailed, was characterised by the allotment of the first three-year tender towards the end of December, which simultaneously replaced the one-year

tender originally scheduled for this date. A total of €489.2 billion was demanded and allotted, making it the highest ever tender volume since the establishment of the Eurosystem. With 523 bidders, the volume was allotted to significantly fewer counterparties than the very first, similarly large one-year tender initiated at the end of June 2009 (1,121 bidders). The high levels of demand for the three-year tender were probably due in large part to uncertainties surrounding refinancing and a general sense of cautiousness, although the attractive conditions for this period (allotment at the average rate of the main refinancing operations carried out over the life of this operation) are also likely to have played a role. To make it easier for the credit institutions to switch from the main refinancing operation to the three-year tender, the Eurosystem additionally conducted a one-day liquidity-providing bridge operation in the same week. However, the net liquidity effect from the allotment of the three-year tender was significantly lower than the actual allotment volume. Numerous banks used this opportunity to transfer their total volume of €45.7 billion obtained from the one-year tender at the end of September to the three-year tender, significantly reducing their demand in the previous main refinancing operation and the regular three-month tender, with the effect that the Eurosystem only allotted an additional €213 billion in the week before Christmas. As a result, the outstanding tender volume rose strongly (to €801 billion on average over the period) and average recourse to the deposit facility in the Eurosystem likewise increased sharply to €399 billion, despite the fact that demand for liquidity from autonomous factors had risen to €258 on average. The overnight rates fell perceptibly following the allotment of the three-year tender, meaning that, on average over the period, the EONIA declined to 0.45% (55 basis points below the key interest rate) and the volume-weighted secured overnight rate on GC Pooling dropped to 0.35% (65 basis points below the key interest rate). On account of the more favour-

### Factors determining bank liquidity<sup>1</sup>

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

| Item                                                                                                   | 2011/2012       |                 |                  |
|--------------------------------------------------------------------------------------------------------|-----------------|-----------------|------------------|
|                                                                                                        | 12 Oct to 8 Nov | 9 Nov to 13 Dec | 14 Dec to 17 Jan |
| <b>I Provision (+) or absorption (-) of central bank balances due to changes in autonomous factors</b> |                 |                 |                  |
| 1 Banknotes in circulation (increase: -)                                                               | - 6.5           | - 8.0           | - 14.3           |
| 2 Government deposits with the Eurosystem (increase: -)                                                | - 7.9           | - 5.9           | - 3.9            |
| 3 Net foreign assets <sup>2</sup>                                                                      | + 41.1          | + 10.0          | + 61.8           |
| 4 Other factors <sup>2</sup>                                                                           | - 7.7           | + 5.1           | - 77.2           |
| <b>Total</b>                                                                                           | <b>+ 19.0</b>   | <b>+ 1.2</b>    | <b>- 33.6</b>    |
| <b>II Monetary policy operations of the Eurosystem</b>                                                 |                 |                 |                  |
| 1 Open market operations                                                                               |                 |                 |                  |
| (a) Main refinancing operations                                                                        | + 3.1           | + 41.9          | - 68.6           |
| (b) Longer-term refinancing operations                                                                 | + 13.5          | + 1.9           | + 238.3          |
| (c) Other operations                                                                                   | - 0.6           | + 5.9           | + 8.0            |
| 2 Standing facilities                                                                                  |                 |                 |                  |
| (a) Marginal lending facility                                                                          | + 1.3           | + 1.6           | + 1.6            |
| (b) Deposit facility (increase: -)                                                                     | - 35.9          | - 49.1          | - 145.6          |
| <b>Total</b>                                                                                           | <b>- 18.6</b>   | <b>+ 2.2</b>    | <b>+ 33.7</b>    |
| <b>III Change in credit institutions' current accounts (I + II)</b>                                    | <b>+ 0.2</b>    | <b>+ 3.3</b>    | <b>+ 0.1</b>     |
| <b>IV Change in the minimum reserve requirement (increase: -)</b>                                      | <b>- 0.1</b>    | <b>- 1.6</b>    | <b>+ 0.7</b>     |

<sup>1</sup> For longer-term trends and the Deutsche Bundesbank's contribution, see pages 14\* and 15\* of the Statistical Section of this Monthly Report. <sup>2</sup> Including end-of-quarter valuation adjustments with no impact on liquidity.

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able liquidity conditions, the underlying turnover also shrank, most noticeably in the secured market, to €30.4 billion (EONIA) and €11.1 billion (GC Pooling).

*Money market rates down again, depo-repo spreads widen*

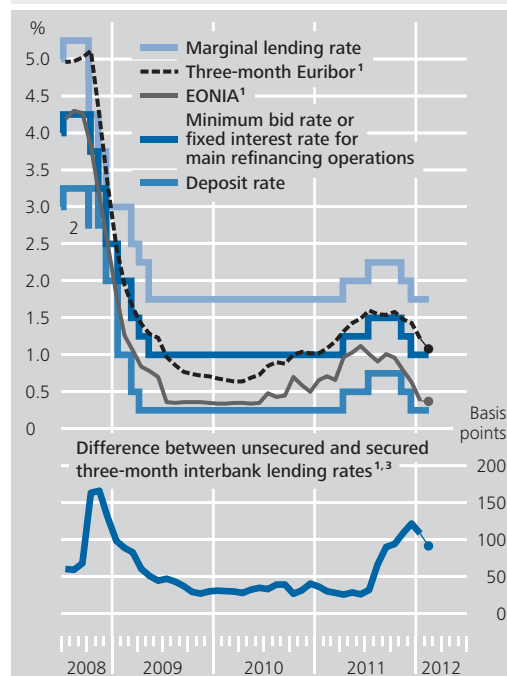
The interest rate cut in November 2011, which came as a surprise for the markets, halted the previously observed upward trend in the longer-term unsecured money market rates. However, these unsecured rates only partially reflected the cuts in the key interest rates up to the end of the year. This was particularly the case for longer-term maturities and was most likely attributable to persistent doubts among banks about the soundness of their possible trading partners. By contrast, secured money market rates fell rather sharply from the beginning of November and reached new lows in December. Hence, the different reactions to the monetary policy measures from the secured and unsecured rates led to a renewed expansion of depo-repo spreads on balance, which then became entrenched at a high level in December and only receded again significantly once the first three-year operation had been carried out. The spread for three-month maturities, which had risen to just under 100 basis points by the end of September, temporarily reached levels of over 120 basis points in December but has stood below 100 basis points again since the beginning of the year.

## Monetary developments in the euro area

*Weakening of monetary developments*

M3 growth weakened sharply in the last quarter of 2011. The seasonally adjusted and annualised three-month rate of the broad monetary aggregate M3, which had stood at 7% at the end of September, dropped to -4½% in the final quarter of 2011. On the one hand, the marked decline in M3 in the autumn months represented a countermovement to the very strong uncertainty-related inflows in the previous quarter. For example, repo transactions by financial corporations, in particular, fell strongly in the autumn months after having sharply expanded in the previous quarter. On the other hand, portfolio shifts into non-monetary assets and accelerated debt redemption by enterprises and households also resulted in substantial outflows from sight deposits and short-

### 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 Eurorepo. • Average from 1 to 16 February 2012.  
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term time deposits. In response to the above-mentioned factors, the annual growth rates of M3 and loans to the domestic private sector decreased from just under 3% and 2½% respectively in the third quarter to around 1½% and 1% respectively in the final quarter of 2011.

The strong decline of M3 in the fourth quarter can mainly be attributed to outflows from marketable instruments (M3-M2) and – to a lesser extent – from short-term time deposits and savings deposits (M2-M1). The extensive reduction in marketable instruments was due to a strong decline in repo transactions between October and December, having contributed a great deal to M3 growth in the previous quarter. The reason for this development was, above all, the decline in secured money market transactions through central counterparties. This decline was presumably a reaction to the Eurosystem’s long-term refinancing operations in the fourth quarter and the associated generous supply of liquidity. Despite a further in-

*Steep decline in repos*

### Open market operations of the Eurosystem\*

| Value date | Type of transaction <sup>1</sup> | Maturity in days | Actual allotment in € billion | Deviation from the benchmark in € billion <sup>2</sup> | Marginal rate/ fixed rate % | Allotment ratio % | Weighted rate % | Cover ratio <sup>3</sup> | Number of bidders |
|------------|----------------------------------|------------------|-------------------------------|--------------------------------------------------------|-----------------------------|-------------------|-----------------|--------------------------|-------------------|
| 12.10.11   | MRO (FRT)                        | 7                | 204.9                         | 160.4                                                  | 1.50                        | 100.00            | –               | 1.00                     | 166               |
| 12.10.11   | S-LTRO (FRT)                     | 28               | 59.1                          | –                                                      | 1.50                        | 100.00            | –               | 1.00                     | 39                |
| 12.10.11   | FTO (–)                          | 7                | –163.0                        | –                                                      | 0.98                        | 77.97             | 0.95            | 1.48                     | 108               |
| 19.10.11   | MRO (FRT)                        | 7                | 201.2                         | 307.2                                                  | 1.50                        | 100.00            | –               | 1.00                     | 164               |
| 19.10.11   | FTO (–)                          | 7                | –165.0                        | –                                                      | 0.91                        | 22.77             | 0.89            | 1.60                     | 108               |
| 26.10.11   | MRO (FRT)                        | 6                | 197.4                         | 265.4                                                  | 1.50                        | 100.00            | –               | 1.00                     | 152               |
| 26.10.11   | FTO (–)                          | 6                | –169.5                        | –                                                      | 0.87                        | 99.66             | 0.85            | 1.37                     | 87                |
| 27.10.11   | LTRO (FRT)                       | 91               | 44.6                          | – <sup>4</sup>                                         | 1.17                        | 100.00            | –               | 1.00                     | 91                |
| 27.10.11   | S-LTRO (FRT)                     | 371              | 56.9                          | – <sup>4</sup>                                         | ...                         | 100.00            | –               | 1.00                     | 181               |
| 01.11.11   | MRO (FRT)                        | 8                | 182.8                         | 306.8                                                  | 1.50                        | 100.00            | –               | 1.00                     | 143               |
| 01.11.11   | FTO (–)                          | 8                | –173.5                        | –                                                      | 0.87                        | 65.12             | 0.83            | 1.14                     | 71                |
| 08.11.11   | FTO (–)                          | 1                | –284.0                        | –                                                      | 1.30                        | 100.00            | 1.27            | 1.00                     | 165               |
| 09.11.11   | MRO (FRT)                        | 7                | 194.8                         | 165.3                                                  | 1.25                        | 100.00            | –               | 1.00                     | 150               |
| 09.11.11   | S-LTRO (FRT)                     | 35               | 55.5                          | –                                                      | 1.25                        | 100.00            | –               | 1.00                     | 47                |
| 09.11.11   | FTO (–)                          | 7                | –183.0                        | –                                                      | 0.69                        | 92.48             | 0.64            | 1.17                     | 99                |
| 16.11.11   | MRO (FRT)                        | 7                | 230.3                         | 365.8                                                  | 1.25                        | 100.00            | –               | 1.00                     | 161               |
| 16.11.11   | FTO (–)                          | 7                | –187.0                        | –                                                      | 0.65                        | 38.50             | 0.61            | 1.39                     | 100               |
| 23.11.11   | MRO (FRT)                        | 7                | 247.2                         | 390.2                                                  | 1.25                        | 100.00            | –               | 1.00                     | 178               |
| 23.11.11   | FTO (–)                          | 7                | –194.5                        | –                                                      | 0.63                        | 91.98             | 0.60            | 1.20                     | 88                |
| 30.11.11   | MRO (FRT)                        | 7                | 265.5                         | 394.5                                                  | 1.25                        | 100.00            | –               | 1.00                     | 192               |
| 30.11.11   | FTO (–)                          | 7                | –194.2                        | –                                                      | 1.25                        | 100.00            | 0.62            | 1.00                     | 85                |
| 01.12.11   | LTRO (FRT)                       | 91               | 38.6                          | – <sup>4</sup>                                         | ...                         | 100.00            | –               | 1.00                     | 108               |
| 07.12.11   | MRO (FRT)                        | 7                | 252.1                         | 382.6                                                  | 1.25                        | 100.00            | –               | 1.00                     | 197               |
| 07.12.11   | FTO (–)                          | 7                | –207.0                        | –                                                      | 1.00                        | 79.68             | 0.65            | 1.19                     | 113               |
| 13.12.11   | FTO (–)                          | 1                | –258.0                        | –                                                      | 1.05                        | 100.00            | 1.03            | 1.01                     | 137               |
| 14.12.11   | MRO (FRT)                        | 7                | 291.6                         | 253.6                                                  | 1.00                        | 100.00            | –               | 1.00                     | 197               |
| 14.12.11   | S-LTRO (FRT)                     | 35               | 41.2                          | –                                                      | 1.00                        | 100.00            | –               | 1.00                     | 42                |
| 14.12.11   | FTO (–)                          | 7                | –207.5                        | –                                                      | 0.80                        | 1.01              | 0.49            | 1.16                     | 110               |
| 21.12.11   | FTO (+)                          | 1                | 141.9                         | –                                                      | 1.00                        | 100.00            | –               | 1.00                     | 73                |
| 21.12.11   | MRO (FRT)                        | 7                | 169.0                         | 146.5                                                  | 1.00                        | 100.00            | –               | 1.00                     | 146               |
| 21.12.11   | FTO (–)                          | 7                | –211.0                        | –                                                      | 0.75                        | 73.34             | 0.53            | 1.22                     | 106               |
| 22.12.11   | LTRO (FRT)                       | 98               | 29.7                          | – <sup>4</sup>                                         | ...                         | 100.00            | –               | 1.00                     | 72                |
| 22.12.11   | S-LTRO (FRT)                     | 1134             | 489.2                         | – <sup>4</sup>                                         | ...                         | 100.00            | –               | 1.00                     | 523               |
| 28.12.11   | FTO (–)                          | 7                | –211.0                        | –                                                      | 0.89                        | 63.12             | 0.56            | 1.25                     | 95                |
| 28.12.11   | MRO (FRT)                        | 7                | 144.8                         | 637.8                                                  | 1.00                        | 100.00            | –               | 1.00                     | 171               |
| 04.01.12   | FTO (–)                          | 7                | –211.5                        | –                                                      | 0.44                        | 48.10             | 0.36            | 1.59                     | 134               |
| 04.01.12   | MRO (FRT)                        | 7                | 130.6                         | 635.6                                                  | 1.00                        | 100.00            | –               | 1.00                     | 138               |
| 11.01.12   | FTO (–)                          | 7                | –213.0                        | –                                                      | 0.34                        | 54.11             | 0.32            | 1.77                     | 131               |
| 11.01.12   | MRO (FRT)                        | 7                | 110.9                         | 552.9                                                  | 1.00                        | 100.00            | –               | 1.00                     | 131               |

\* For more information on the Eurosystem's operations from 13 July 2011 to 11 October 2011, see Deutsche Bundesbank, Monthly Report, November 2011, 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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crease of inflows into money market fund shares and bank debt securities contained in (M3-M2) in the fourth quarter, the slump in repos led to a discernible fall in the seasonally adjusted and annualised growth rate of (M3-M2) to -21½% from a (revised) rate of 27% in the previous quarter.

*Short-term time deposits also perceptibly down*

With respect to short-term time deposits contained in (M2-M1), which had recorded substantial inflows in the first three quarters, a perceptible reduction could likewise be observed in the fourth quarter. Since the build-up of short-term savings deposits also ground to a halt, the seasonally adjusted and annualised

three-month rate of shorter-term bank deposits (M2-M1) was down to just under -3½%. Furthermore, a reduction in overnight deposits caused the highly liquid monetary aggregate M1, which had expanded considerably in the third quarter, to decline slightly as well.

Of the M3 counterparts, the decrease in the banking sector's net external asset position vis-à-vis non-residents had the strongest negative impact on monetary dynamics. This development was driven by a strong reduction in external assets, which was only partially compensated for by the simultaneous decline in external liabilities. The decrease in external assets

*Marked reduction in net external assets*

reflects the fact that, for some time now, euro-area banks have been repatriating funds from abroad. By contrast, the decline in external liabilities reflects the withdrawal of funds previously made available to banks by non-residents.

*Weak lending to private sector, especially to non-financial corporations*

Moreover, weak lending to the domestic private sector had a dampening effect on monetary developments. At the end of December, its annualised and seasonally adjusted three-month rate (adjusted for loan sales and securitisation), which had stood at 2½% in the previous quarter, reached its lowest level (-1%) since summer 2009. The cutback mainly affected the corporate sector and in particular loans to non-financial corporations, for which the seasonally adjusted and annualised three-month rate entered clear negative territory in the period from October to December at just under -3%, after hovering at around 2½% in the preceding three quarters. The sharp outflows from non-financial corporations recorded in the reporting quarter affected all maturities, but mainly those of a short and medium-term nature. The marked decline in short-term loans in December reflects at least in part the elevated level of redemption payments by corporations at the end of the year, which means that a counter-movement can be expected in January. However, long-term lending, too, recorded a noticeable quarter-on-quarter decline for the first time since 1999. On the whole, it should 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.

*Loans to financial corporations also down*

In addition, there was a noticeable reduction in loans to financial corporations, too, in the reporting quarter. However, the majority of these loans were counterparts of highly volatile indirect interbank transactions (reverse repos) contained in (M3-M2). Therefore, restricted lending to this sector does not in itself represent a classical withdrawal of funds from the private non-banking sector.

## Monetary developments in the euro area\*

Changes in € billion, seasonally adjusted

| Monetary aggregate in a balance sheet context                           | 2011   |         |
|-------------------------------------------------------------------------|--------|---------|
|                                                                         | Q3     | Q4      |
| Monetary aggregate M3 (=1+2-3-4-5)                                      | 164.3  | - 111.3 |
| Components:                                                             |        |         |
| Currency in circulation and overnight deposits (M1)                     | 57.0   | - 6.3   |
| Other short-term deposits (M2-M1)                                       | 35.6   | - 32.7  |
| Marketable instruments (M3-M2)                                          | 71.7   | - 72.2  |
| Counterparts                                                            |        |         |
| 1. Total credit to non-MFIs in the euro area                            | 118.4  | 87.8    |
| Credit to general government                                            | 62.6   | 119.7   |
| Credit to private-sector non-MFIs in the euro area <sup>1</sup>         | 55.8   | - 31.9  |
| 2. Net external assets                                                  | 23.8   | - 77.6  |
| 3. Central government deposits                                          | - 35.6 | 39.3    |
| 4. Longer-term financial liabilities to other non-MFIs in the euro area | 69.2   | - 11.0  |
| 5. Other counterparts of M3 (residual)                                  | 55.7   | - 93.2  |

\* Changes for statistical reasons are eliminated. <sup>1</sup> Adjusted for loan sales and securitisation.

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By contrast, loans to households (adjusted for loan sales and securitisation) saw a slight increase in the final quarter of 2011. Driven, in particular, by loans for house purchase – the quantitatively most important component of household borrowing –, the seasonally adjusted and annualised three-month rate of loans to households stood at around 1% compared with just under 1½% in the previous quarter.

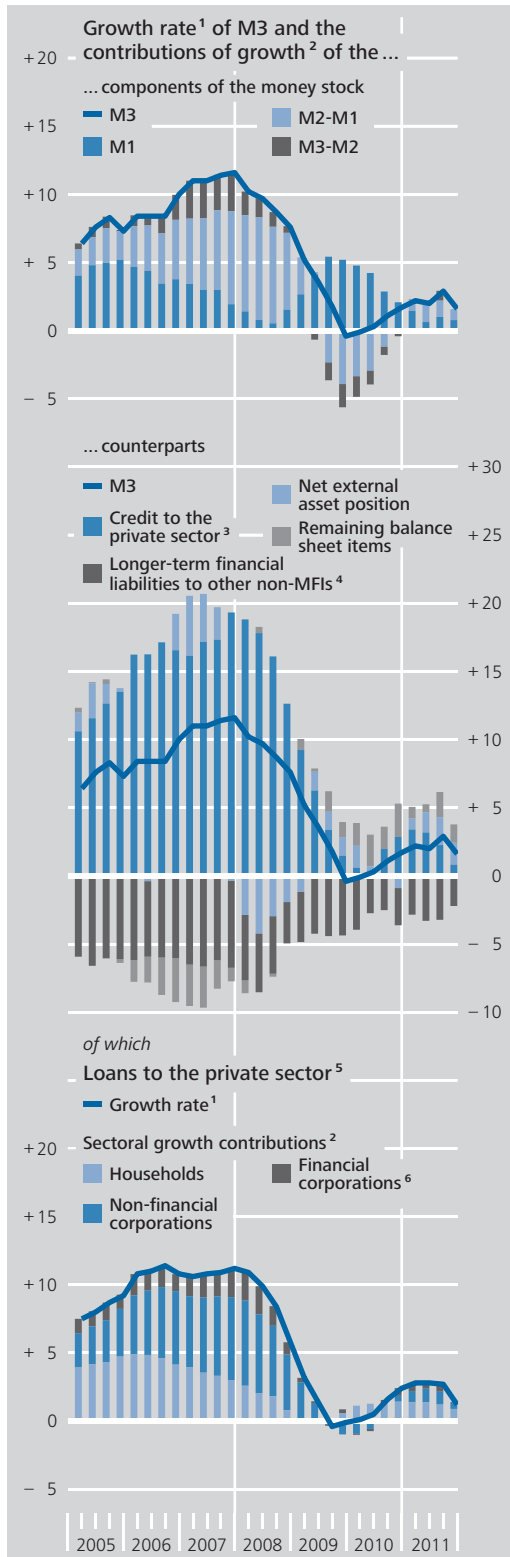
*Further increase in loans to households, however*

Money growth was also supported by the strong increase in credit to general government, which had already risen markedly in the previous quarter. One reason for this was the purchasing of government securities by central banks of the Eurosystem, another was the non-occurrence of a reduction in holdings of government securities by monetary financial institutions (excluding the ESCB) as had been frequently observed at the end of the last few years. This caused the seasonally adjusted and annualised three-month rate for credit to general government, which had stood at 8.5% at

*Strong increase in credit to general government in form of securities*

## 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.

the end of September, to virtually double in the final quarter. The positive contribution to M3 made by loans to general government was only partly offset by the increased deposits of central governments in the fourth quarter.

The fact that monetary capital formation declined for the first time in a long while also had an expansionary effect on M3 in the fourth quarter. Continued significant inflows into capital and reserves coupled with a slight increase in long-term time deposits were offset by marked outflows in the case of long-term savings deposits and, above all, a sharp reduction in bank debt securities with a maturity of over two years. Half of the decline in long-term bank debt securities was compensated for by the rise in short-term bank debt securities contained in (M3-M2), which was particularly evident in December. This partial substitution is probably a result of the Eurosystem's three-year refinancing operation, which is likely – from the investors' point of view – to have reduced the risk associated with said shorter-term debt instruments. Overall, the negative development of monetary capital indicates that the outflows from M3 are probably to some degree also attributable to portfolio shifts towards other non-monetary assets.

*Monetary capital formation negative*

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 associated with these forecasts remains high.

*Money-based forecasts with balanced inflation risks*

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

Following the pattern of monetary developments in the euro area, the deposit business of German banks likewise lost momentum in the last quarter of 2011, stagnating at a seasonally adjusted and annualised three-month rate of 0% after experiencing a sharp expansion in the

*Stagnation in the deposit business*



preceding three quarters of the year. The key reason for the slowed growth, which had hitherto been stable, was a decline in both time deposits and long-term savings deposits. The decrease in these kinds of deposits was offset by a noticeable increase in overnight deposits, whose remuneration retained its appeal in the fourth quarter, unlike other shorter-term forms of investment. Apart from the portfolio shifts, an additional cause for the stagnant growth of deposits is likely to have been an end-of-year effect, which had already made itself felt in December of each of the last two years in the form of an increase in the repayment of short-maturity loans to non-financial corporations and was linked to a fall in short-term time deposits.

*Reduction of longer-term deposits continues*

The decline in longer-term deposits by domestic customers with credit institutions in Germany, which had already been observed in previous quarters, persisted strongly in the fourth quarter. In addition to the continued downward tendency in longer-term time deposits, savings deposits with an agreed period of notice of over three months fell markedly, too. While the decline in long-term savings deposits was mainly attributable to households, the reduction in time deposits was determined by insurance corporations and non-financial corporations.

*Only marginal increase in banks' lending to domestic non-banks*

In the last quarter of 2011, loans from German banks to domestic non-banks likewise deviated from the moderate growth path of the previous quarter. The corresponding seasonally adjusted and annualised three-month rate stood at around 0%. Although credit to the domestic private sector continued to increase, credit to general government decreased to virtually the same extent. As was the case in the previous quarter, it was mainly loans to financial corporations that made up the bulk of the increase in lending to the domestic private sector. Their increase was due to the expansion of secured interbank transactions through a central counterparty in October. However, such loans do not entail any increased provision of credit to the private non-bank sector.

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

Changes in € billion, seasonally adjusted

| Item                                       | 2011   |       |
|--------------------------------------------|--------|-------|
|                                            | Q3     | Q4    |
| Deposits of domestic non-MFIs <sup>1</sup> |        |       |
| Overnight                                  | 26.9   | 13.2  |
| With agreed maturities                     |        |       |
| of up to 2 years                           | 26.9   | - 7.1 |
| of over 2 years                            | - 2.3  | - 2.8 |
| Redeemable at notice                       |        |       |
| of up to 3 months                          | - 0.7  | - 0.2 |
| of over 3 months                           | 0.2    | - 4.1 |
| Lending                                    |        |       |
| to domestic general government             |        |       |
| Loans                                      | - 10.3 | - 7.4 |
| Securitised lending                        | - 1.8  | - 4.3 |
| to domestic enterprises and households     |        |       |
| Loans                                      | 23.7   | 20.5  |
| of which to households <sup>2</sup>        | 3.0    | 1.7   |
| to non-financial corporations <sup>3</sup> | 4.2    | - 3.2 |
| Securitised lending                        | - 5.3  | - 7.8 |

\* 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. <sup>1</sup> Enterprises, households and general government excluding central government. <sup>2</sup> Including non-profit institutions serving households. <sup>3</sup> Corporations and quasi-corporations.

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In contrast to lending behaviour in the euro area as a whole, only lending to non-financial corporations was down in the German private sector, meaning that the seasonally adjusted and annualised three-month rate of loans to non-financial corporations stood at -1½% at the end of the reporting quarter. This decline was largely determined by a sharp reduction in loans with short maturities in December. Big banks, in particular, recorded a decline in (short-term) loans to non-financial corporations at the end of the year. Longer-term maturity segments, however, recorded further increases.

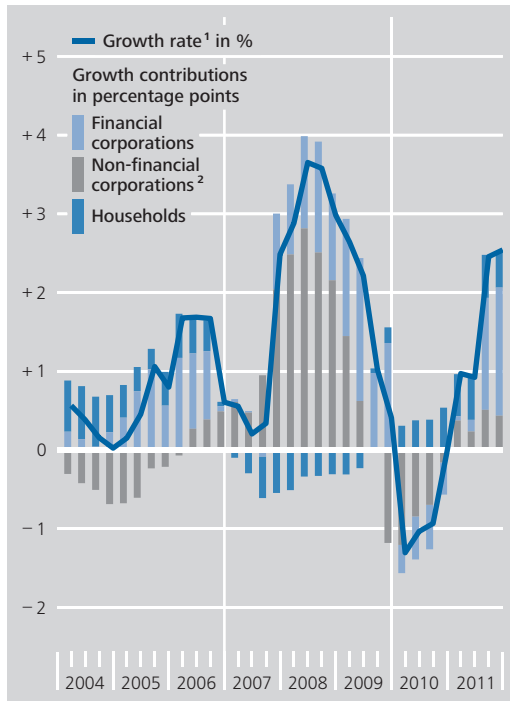
*Lending to non-financial corporations down due to end-of-year effect*

In addition to loans to financial corporations, German banks also increased their loans to domestic households appreciably in the reporting quarter. However, at a (seasonally adjusted and annualised) growth rate of ½% during the reporting quarter, loans by German banks to households in Germany grew at a slightly lower rate than in the previous quarter. As in the past, cooperative banks and savings banks made the

*Decline in other loans to households more than offset by expansion of loans for house purchase*

### Loans of German banks to selected sectors

Seasonally adjusted, end-of-quarter data



1 Year-on-year rate of change. 2 Corporations and quasi-corporations.  
 Deutsche Bundesbank

greatest contribution to this expansion. In the final quarter of the year, however, the increase in household debt was almost exclusively driven by a further rise in loans for house purchase, growth of which, at just under 1½%, was slightly up on the quarter. By contrast, there was a slight decrease in other loans to households.

*Lending policies in Germany mixed*

According to data provided by banks participating in January's Bank Lending Survey, credit standards for corporate clients and households remained largely unchanged. A mixed development did, however, occur across all business areas with regard to margins, which in the case of loans to enterprises, were widened considerably for average as well as for risky borrowers, left unadjusted in the case of loans to households for consumption purposes and narrowed considerably with regard to loans for house purchase.<sup>1</sup> For the first quarter of 2012, the participating institutions intend to keep their credit standards unchanged for the most part,

with the exception of a slight tightening in loans to enterprises.

At the same time, the participating banks recorded an overall perceptible increase in the demand for funds in the fourth quarter, which was especially pronounced in the case of loans for house purchase and long-term loans to enterprises.

*Credit demand in Germany up perceptibly*

In contrast to Germany, credit standard developments in the fourth quarter in the rest of the euro area were characterised, along with reduced heterogeneity, by a marked tightening, which was particularly striking in the case of loans to enterprises and loans to households for house purchase. Furthermore, there was a sharp fall in demand, especially from households.

*Euro-area credit supply conditions tightened markedly*

The Bank Lending Survey contained two additional questions regarding the impact of the financial and sovereign debt crisis on the banks' wholesale funding conditions and credit standards. The German banks surveyed perceived their funding situation on the money and capital markets as being only slightly worse. According to the data they provided, the tighter conditions for the issuance of medium to long-term debt securities were mainly to blame. In the euro area, on the other hand, banks again reported a noticeable overall deterioration in funding conditions, especially in the large-volume lending segment.

*Constraints to funding situation ...*

Furthermore, the German banks stated that the tensions in the European bond markets, taken in isolation, had led to a slight tightening of standards in lending to enterprises, whereas no impact was observed on standards in retail lending. Euro-area banks, however, found that the financial and sovereign debt crisis was exerting a restrictive influence on credit standards in all business areas covered by the survey.

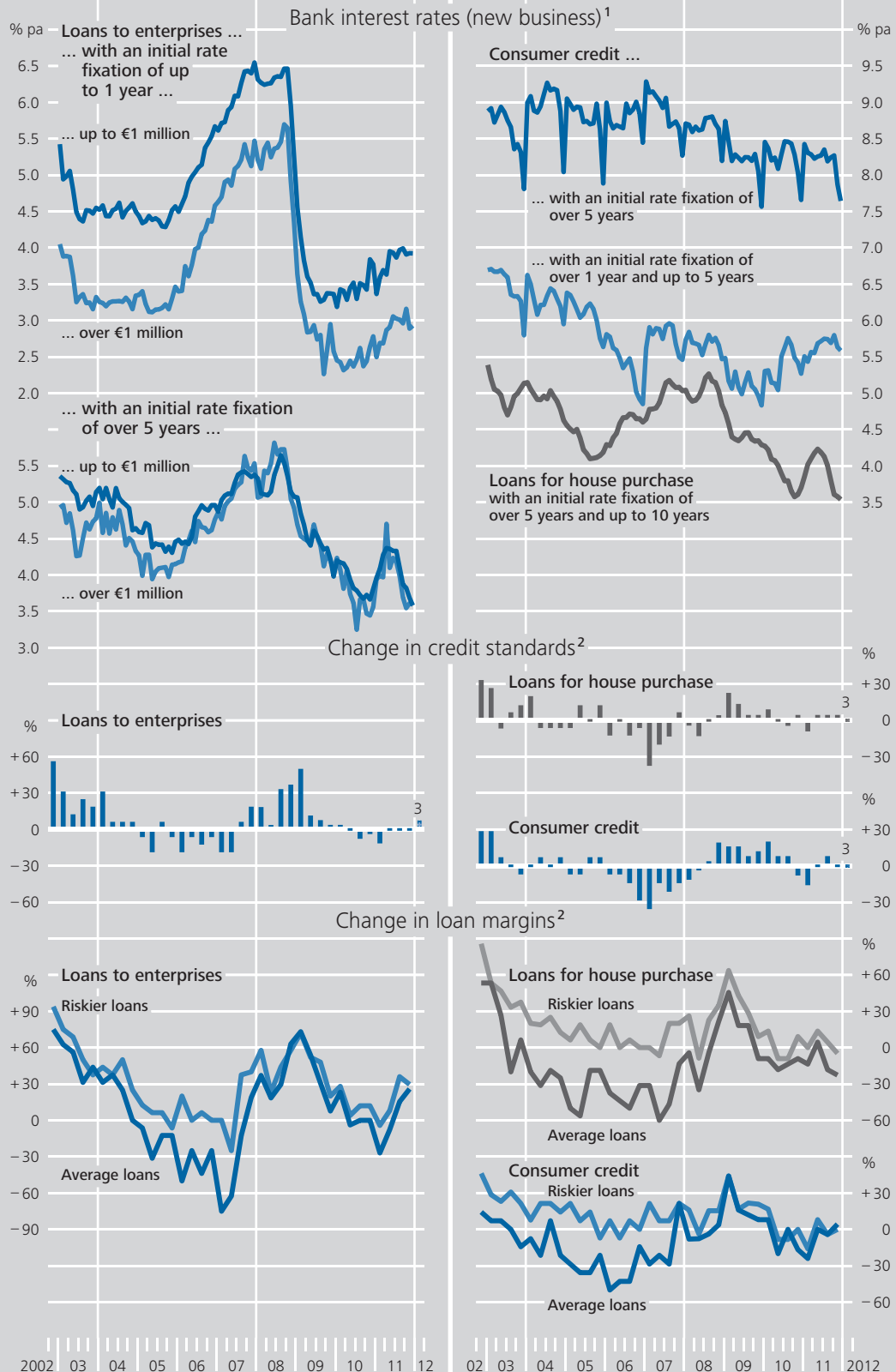
*... and tightening of credit standards over the course of the financial and sovereign debt crisis stronger in the euro area than in Germany*

<sup>1</sup> The aggregate survey results for Germany may be found at [http://www.bundesbank.de/volkswirtschaft/vo\\_veroeffentlichungen.en.php](http://www.bundesbank.de/volkswirtschaft/vo_veroeffentlichungen.en.php).

## Banking conditions in Germany

### Credit to non-financial corporations

### Credit to households



**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 2012 Q1.

*Measures in preparation for stricter regulation more extensive in sample of European banks*

Moreover, banks were asked two further questions regarding the impact which higher capital requirements for banks were having on lending policies.<sup>2</sup> Compared with the sample of European banks, the measures carried out by the surveyed German banks in preparation for a stricter regulation were less extensive in the second quarter of 2011. For instance, the participating German institutions indicated that they mainly achieved an increase in their regulatory capital by retaining profits and reducing their exposure to risky loans, whereas the surveyed European institutions also increasingly improved their capital base by issuing fund shares and reducing the number of average-risk loans. The German survey participants intend to go on implementing the measures introduced in the second half of 2011 on a broader basis in the first half of 2012. It is likewise planned to extend the lending restrictions to include borrowers with average credit ratings as well during this period. The European respondents, however, reported that they expect a reduction in lending, especially to risky borrowers, accompanied by a lower issue volume of fund shares.

*Regulations in Germany currently have no impact on credit standards; slight tightening planned for the future, however*

In the past half year, the surveyed German banks did not see any effects on credit standards in the surveyed business areas stemming from the more stringent capital requirements planned for the future. In light of the regulation, they do intend to slightly tighten their standards for loans to enterprises in the first half of 2012, however. Unlike the surveyed German institutions, the European banks indicated that they had already tightened their standards

for lending to enterprises – and to large corporations in particular – in view of the stricter capital requirements, as early as the second half of 2011. In addition, European banks are planning to implement further restrictive changes in this business area in the first half of 2012 as well.

In the final quarter of 2011, bank lending rates were down again across all business areas. Interest rates for long-term loans to enterprises stood at 3.6%, irrespective of their size, and were thus ten basis points below the level for the previous quarter for large-volume loans and just under 30 basis points below that for small-volume loans. The conditions for loans for house purchase with an interest rate fixation of more than five years also decreased again by around 25 basis points to an average of 3.5% and at the end of the year stood at their lowest level since the start of the series in 2003. Following the seasonal pattern of the past few years, conditions for consumer loans of all rate fixation periods fell sharply such that those for loans of over five years stood at 7.6% at the end of the year. On the whole, the decreases outweighed the developments in the capital markets. This is probably attributable to the slight lag in banks' interest rate pass-through and the very sharp declines in capital market rates in the previous quarter.

*Conditions for long-term bank loans worsen*

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<sup>2</sup> Stricter regulatory capital requirements of banks are set out in the new Basel III framework, the European Banking Authority's guidelines that apply to major international credit institutions and other specific national regulations that have recently been approved or will be approved in the near future.