Monetary policy and banking business

Monetary policy and money market developments

Governing Council of the ECB leaves key rates unchanged

The economic outlook for the euro area has once again deteriorated since the beginning of the year. At the same time, inflation forecasts for 2012 required significant upward revision, above all, given the renewed increase in crude oil prices. However, the Governing Council of the ECB believes that inflation will return to a level compatible with stability over the policy-relevant horizon. This estimation is also supported by the still subdued underlying pace of monetary expansion: whereas the monetary aggregate M3 increased strongly in the reporting quarter, growth in loans to the private sector was perceptibly weaker in the euro area, leading to a distinct divergence between the development of M3 and lending to the private sector. Against this backdrop, the Governing Council of the ECB kept key rates at the level they had been at thus far. The main refinancing rate therefore remains unchanged at the historically low level of 1%. The interest rate for recourse to the marginal lending facility remains unchanged at 1¾%, while the interest rate on the deposit facility, too – at ¼% – is the same as before.

Implementation of non-standard measures agreed in December

From a monetary policy perspective, the reporting period was marked by the implementation of the non-standard measures agreed by the Governing Council of the ECB in December 2011. In particular, on 29 February 2012 a second refinancing operation with the unusually long maturity of three years was offered, recourse to which – at an overall amount of €529.5 billion – was extensive. The bidding and allotment volume of the first three-year refinancing operation of 21 December 2011 had stood at €489.2 billion. The bulk of the volume offered with the two three-year operations went to Eurosystem counterparties based in Spain, Italy and France. While a large number of counterparties of the Bundesbank made use of the operations, too, the total volume allotted to these institutions was rather meagre by comparison.

Banks' interest in the use of these special operations is mainly motivated by two aspects. On the one hand, the three-year operations represent a financing instrument, the interest rate of which may be a great deal lower than that of other comparable sources of financing – especially for banks facing higher interest rate spreads on the capital market. Hence, the institutions can, for example, replace maturing debt securities by participating in these three-year refinancing operations. On the other hand, banks may also use the funds provided by the Eurosystem in order to conduct additional lending business without having to acquire the necessary funds on the market. While there are hardly any signs of banks increasing their lending to date, it is becoming more and more evident that institutions purchased fixed income securities from public issuers in particular (see box on pages 26 to 28).

The securities held by the Eurosystem under the Securities Market Programme (SMP) hardly increased on balance from the beginning of the year. This development can be attributed to the Eurosystem's clearly reduced interventionism on the one hand and to redemptions of maturing debt on the other. Originally, the volume of the second Covered Bond Purchase Programme (CBPP2), which was agreed in October 2011 and carried out as of November 2011, was intended to be €40 billion by the end of October 2012, of which an overall amount of around €11.5 billion has been accumulated by the Eurosystem so far. It may be assumed that the three-year refinancing operations had the effect of reducing banks' new covered bonds issuance while at the same time increasing the demand for these securities. Against this backdrop, implementation of the CBPP2 was rather

Money market management and liquidity needs

During the three reserve maintenance periods from 18 January to 10 April 2012, euro-area credit institutions' need for central bank liquidity determined by autonomous liquidity factors rose by €77.8 billion in net terms. This increase was driven mainly by general government deposits with the Eurosystem, which rose sharply by €78.6 billion on balance. By contrast, the demand for liquidity from banknotes in circulation decreased by €12.5 billion, owing mainly to the usual seasonal fall in demand for banknotes in the January-February 2012 maintenance period, counteracting the sharply increased demand in the pre-Christmas period. If net foreign reserves and the other factors are taken together, thereby eliminating liquidity-neutral valuation effects, the need for liquidity likewise declined by €11.7 billion. The minimum reserve requirement fell by €101.6 billion on average compared with the previous reporting period, mainly as a result of the ECB Governing Council's decision of 8 December 2011 to halve the reserve ratio from 2% to 1% as of the maintenance period beginning 18 January.

Although the financing needs of the credit institutions calculated from the changes in the autonomous factors and the lowering of the minimum reserve requirement fell by €23.8 billion on balance, credit institutions' demand for funds in refinancing operations increased considerably. The main event during the period under review was the allotment of the second three-year tender which, with a volume of €529.5 billion, caused a strong rise in existing excess liquidity. Like all other liquidity-providing open market operations, this tender was also conducted as a fixed-rate procedure with full allotment. In its decision of 6 October 2011, the ECB Governing Council announced that the generous allotment policy of the main and longer-term refinancing operations was to be retained until the end of the June-July 2012 maintenance period. The longer-term refinancing operations with maturities of three months or more were again allotted at the fixed rate, which is indexed to the average refinancing rate of the main refinancing operations over the life of the operation. As a further non-standard measure, at its meeting on 9 February 2012, the ECB Governing Council approved specific national eligibility criteria and risk control measures for the temporary acceptance in a number of countries of additional credit claims as collateral in Eurosystem credit operations.

The considerably higher demand for liquidity in the refinancing operations was only visible in the volume of longer-term operations which, comparing period averages, rose sharply by around €466 billion (net), while the volume of main refinancing operations dropped by €113 billion. The noticeably higher overall volume of outstanding refinancing was accompanied by a strong increase of €372 billion in the average recourse to the deposit facility in the period under review (comparing the period averages). By contrast, recourse to the marginal lending facility over the three observation periods was down slightly, with the facility sometimes tapped for amounts of up to €11.8 billion in the March-April period.

Purchases under the Securities Markets Programme (SMP) were largely discontinued in the period under review; the last purchases were made on 9 February 2012. Because the volume of maturing SMP securities was larger than the volume of purchases, the portfolio fell by €3.5 billion to €214 billion

during the period. The weekly liquidity-absorbing fine-tuning operations fully neutralised the liquidity-providing effect resulting from the SMP. After the three-year tenders, the willingness of banks to place liquidity in the liquidity-absorbing operations increased significantly, resulting in a difference of just one basis point between the allotment rates and the 0.25% interest rate of the deposit facility. The volume of the first Covered Bond Purchase Programme (CBPP) decreased by €1.3 billion to €56.8 billion due to maturities. However, the new CBPP2 had increased by €4.9 billion to €9.6 billion by the end of the third maintenance period on 10 April.

In the January-February 2012 maintenance period, excess liquidity increased compared with the previous period due to the much higher refinancing volume resulting from the first three-year tender and the halving of the minimum reserve requirement to €103.3 billion. At €868.1 billion, the average volume of outstanding open market operations, including the purchase programmes and the SMP absorption tenders, remained almost unchanged in comparison to the previous period (€864.6 billion). Because the average autonomous factors rose to €273.4 billion (after €258.8 billion in the previous period), the average excess liquidity (central bank balances plus the deposit facility minus the marginal lending facility minus the reserve requirement) stood at €491.4 billion compared to €398.6 billion in the previous period. This caused the average recourse to the deposit facility to rise €89.7 billion to €489.0 billion. By contrast, recourse to the marginal lending facility in the Eurosystem declined, but still averaged €2.3 billion over the period (previous period: €6.0 billion). The unsecured overnight rate EONIA stood at 0.37% on average over the period, ie around 63 basis points below the main refinancing rate and therefore lower than in the previous period (55 basis points below the main refinancing rate). Secured overnight money on the Eurex Repo (GC Pooling, ECB Basket) reacted more strongly to the excess liquidity, standing at 0.27% on average. At around €30 billion on average, EONIA turnover was rather low; secured overnight turnover on the GC Pooling trading platform amounted to €9.9 billion.

In the February-March maintenance period, the demand for liquidity increased substantially, at first in the main refinancing operations and then, due to the second three-year tender, in the longer-term refinancing operations, with shifts in the refinancing structure finally causing demand for the main tender to fall again. The high level of interest also shown in the second three-year tender exceeded market expectations. This non-standard measure led to a net liquidity inflow of €305 billion (compared with €213 billion in the first three-year tender as at 22 December 2011). The number of participating credit institutions, which rose sharply to 800 (523 in the first tender), indicated that many banks did not want to pass up this opportunity. The average volume of outstanding open market operations (including the purchase programmes and the SMP absorption tenders) rose considerably by €149.7 billion to €1,017.8 billion. Together, the two three-year tenders accounted for 90% of all tender operations. The average autonomous factors rose from €273.4 billion in the previous period to €290.2 billion, meaning that, on balance, average recourse to the deposit facility increased by €132.0 billion to €621.0 billion. Recourse to the marginal lending facility in the Eurosystem averaged €2.2 billion. The EONIA stood at 0.36% on average over the period, down by one basis point in comparison to the previous period. The EONIA fluctuated within a very narrow range. At 0.245% on average, the secured rate for

Factors determining bank liquidity[1]

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

Item	2012		
	18 Jan to 14 Feb	15 Feb to 13 Mar	14 Mar to 10 Apr
I Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors			
1 Banknotes in circulation (increase: –)	+ 13.6	+ 1.3	– 2.4
2 Government deposits with the Eurosystem (increase: –)	– 32.4	– 28.9	– 17.3
3 Net foreign assets[2]	+ 14.4	– 10.1	– 20.6
4 Other factors[2]	– 10.3	+ 21.0	– 6.1
Total	– 14.7	– 16.7	– 46.4
II Monetary policy operations of the Eurosystem			
1 Open market operations			
(a) Main refinancing operations	– 48.8	– 31.5	– 32.7
(b) Longer-term refinancing operations	+ 56.3	+ 176.5	+ 233.3
(c) Other operations	– 3.9	+ 4.7	– 3.8
2 Standing facilities			
(a) Marginal lending facility	– 3.7	– 0.1	+ 0.8
(b) Deposit facility (increase: –)	– 89.7	– 132.0	– 150.3
Total	– 89.8	+ 17.6	+ 47.3
III Change in credit institutions' current accounts (I + II)	– 104.2	+ 0.8	+ 0.7
IV Change in the minimum reserve requirement (increase: –)	+ 103.7	– 1.0	– 1.1

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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the overnight maturity on GC Pooling was therefore even lower than the deposit facility rate. Overall, the credited amount from the second three-year tender resulted in a decline in turnover in the interbank market of around 30% in both segments.

In the March-April maintenance period, the average volume of outstanding open market operations rose a further €196.7 billion to €1,214.5 billion. The higher volume in the main tenders partially compensated for the clear increase in the autonomous factors by around €46 billion on average to €336.2 billion, which was due mainly to larger general government deposits. On balance, average recourse to the deposit facility rose €150.4 billion to reach €771.3 billion. The overnight rate EONIA hardly fluctuated in this period either and, at 0.355% on average, remained at the level of the previous period despite the further increase in liquidity. At the end of the quarter, the EONIA rose four basis points, following the typical pattern for these particular balance sheet data, albeit at a much more subdued level (previous year: +31 basis points). In this maintenance period, secured overnight money trading on GC Pooling – at least as measured by the published reference interest rate for the ECB basket – fluctuated as little as the EONIA, which, with rather low average turnovers of €6.8 billion, recently led to an average secured overnight money rate of 0.25%, which was equal to the deposit facility rate.

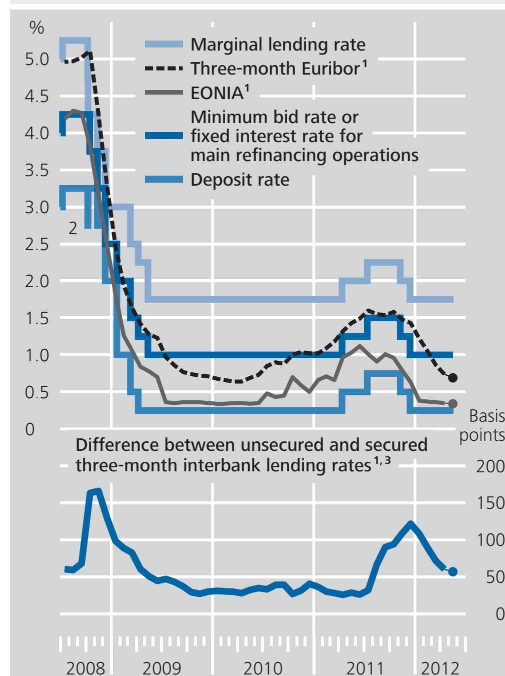
sluggish compared with the first programme for the purchase of covered bonds.

Rise in excess liquidity as a result of the second three-year operation

As a result of the extensive participation by banks in the second three-year operation in particular, the volume of the refinancing operations increased again by around €250 billion compared with the end of 2011 to currently just over €1.1 trillion. This caused excess liquidity in the banking system – measured in terms of average recourse to the deposit facility – to leap again to over €770 billion of late as an average for the reserve period from 11 April to 8 May 2012; it was thus again clearly above the previous record level. On the whole, there is currently no indication that the large-volume provision of funds to banks is directly giving rise to credit and monetary aggregate developments that have an inflationary effect. However, the risks associated with this must not be ignored. There is, for example, always the danger of creating wrong incentives for banks and other players when introducing non-standard monetary policy measures. It would be particularly problematic if this led to necessary structural reforms in the real economy or the financial sector being delayed or not being carried out at all. In addition, monetary policy makers must focus on limiting the balance-sheet risks associated with the non-standard monetary policy measures and on maintaining the separation between monetary policy and financial policy tasks. It is essential that the measures taken do not create risks to price stability. Therefore, it is necessary to resort to such extraordinary instruments only in exceptional cases and temporarily.

The further increase in excess liquidity exerted virtually no further downward pressure on the interbank overnight rate: the unsecured overnight rate EONIA has fallen by only a few basis points since the beginning of 2012 and currently stands at just under 0.35%, which is approximately 10 basis points above the deposit rate.

Money market interest rates in the euro area



1 Monthly averages. **2** Only on 8 October 2008 2.75%. **3** Three-month Euribor less three-month Eurepo. • Average from 1 to 18 May 2012.

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Unsecured money market rates declining while depo-repo spreads narrower

The additional funds provided by the Eurosystem with the three-year operations and the implementation of the measures agreed by the Governing Council of the ECB in the fourth quarter of 2011 jointly contributed to a more relaxed financing situation for banks in the euro area. The decline of unsecured money market rates and risk premiums indicated in January continued steadily in the two subsequent months and finally slowed down somewhat in April. This means that the difference in interest rates on unsecured and secured money market operations with a maturity of three months has fallen by approximately 60 basis points since the beginning of the year to just under 0.6 percentage point of late.

Monetary developments in the euro area

In the first quarter of 2012, the broad monetary aggregate M3 recovered perceptibly from its

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
18.01.12	MRO (FRT)	7	126.9	471.9	1.00	100.00	–	1.00	143
18.01.12	S-LTRO (FRT)	28	38.7	–	1.00	100.00	–	1.00	44
18.01.12	FTO (–)	7	– 217.0	–	0.31	52.18	0.29	1.74	118
25.01.12	MRO (FRT)	7	130.3	577.8	1.00	100.00	–	1.00	136
25.01.12	FTO (–)	7	– 219.0	–	0.30	31.18	0.28	1.58	113
26.01.12	LTRO (FRT)	91	19.6	–	[4] 1.00	100.00	–	1.00	54
01.02.12	MRO (FRT)	7	115.6	593.1	1.00	100.00	–	1.00	135
01.02.12	FTO (–)	7	– 219.0	–	0.28	88.86	0.27	1.49	100
08.02.12	MRO (FRT)	7	109.5	572.5	1.00	100.00	–	1.00	135
08.02.12	FTO (–)	7	– 219.0	–	0.28	40.65	0.27	1.57	97
15.02.12	MRO (FRT)	7	142.8	465.3	1.00	100.00	–	1.00	160
15.02.12	FTO (–)	7	– 219.5	–	0.28	21.38	0.27	1.60	97
15.02.12	S-LTRO (FRT)	28	14.3	–	1.00	100.00	–	1.00	18
22.02.12	MRO (FRT)	7	166.5	567.0	1.00	100.00	–	1.00	169
22.02.12	FTO (–)	7	– 219.5	–	0.27	84.40	0.27	1.70	91
29.02.12	MRO (FRT)	7	29.5	359.5	1.00	100.00	–	1.00	83
29.02.12	FTO (–)	7	– 219.5	–	0.27	57.10	0.26	1.51	79
29.02.12	FTO (+)	1	133.9	–	1.00	100.00	–	1.00	71
01.03.12	S-LTRO (FRT)	1092	529.5	–	[4] …	100.00	–	1.00	800
01.03.12	LTRO (FRT)	91	6.5	–	[4] …	100.00	–	1.00	30
07.03.12	MRO (FRT)	7	17.5	922.5	1.00	100.00	–	1.00	65
07.03.12	FTO (–)	7	– 219.5	–	0.26	81.36	0.26	2.06	106
14.03.12	MRO (FRT)	7	42.2	780.7	1.00	100.00	–	1.00	75
14.03.12	FTO (–)	7	– 218.0	–	0.26	61.72	0.26	2.01	91
14.03.12	S-LTRO (FRT)	28	9.8	–	1.00	100.00	–	1.00	19
21.03.12	MRO (FRT)	7	59.5	919.0	1.00	100.00	–	1.00	78
21.03.12	FTO (–)	7	– 218.0	–	0.26	59.27	0.26	1.97	92
28.03.12	MRO (FRT)	7	61.1	894.1	1.00	100.00	–	1.00	81
28.03.12	FTO (–)	7	– 213.5	–	0.26	84.37	0.26	1.51	82
29.03.12	LTRO (FRT)	91	25.1	–	[4] …	100.00	–	1.00	48
04.04.12	MRO (FRT)	7	62.6	891.1	1.00	100.00	–	1.00	80
04.04.12	FTO (–)	7	– 213.5	–	0.26	68.02	0.26	1.94	78

***** For more information on the Eurosystem's operations from 12 October 2011 to 17 January 2012, see Deutsche Bundesbank, Monthly Report, February 2012, p 26. **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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Recovery of monetary developments

marked decline in the autumn months. The seasonally adjusted and annualised three-month rate climbed by 11 percentage points to just under 8% between the end of December and the end of March. This sharp growth resulted from portfolio shifts by non-banks in favour of sight deposits and short-term time deposits on the one hand. On the other hand, banks once again expanded securitised lending to general government strongly in the reporting quarter. Whereas growth of the monetary aggregate M3 in the first quarter picked up where the recovery up to the summer of 2011 had left off, lending to the domestic private sector was less dynamic. The annual growth rate of loans (adjusted for loan sales and securitisations) to the private sector remained virtually unchanged at 1¼% in the first quarter of 2012, while the annual growth rate of M3 rose from 1½% to just above 3% in the reporting quarter.

Strong increase in short-term deposits …

The strong growth in the monetary aggregate M3 in the first three-month period was supported by all components. A third of the increase was attributable to the narrow monetary aggregate M1, the (seasonally adjusted and annualised) three-month rate of which rose from ½% at year-end to just over 5% at the end of the first quarter. The main reason for this rise

was the sharp increase in sight deposits by other financial intermediaries (OFIs), which shifted funds away from longer-term forms of investment. However, with regard to short-term time deposits and savings deposits (M2-M1), the sharp upward movement was primarily driven by households' portfolio decisions. The fact that interest on these deposits for households developed more favourably in the reporting quarter than interest on long-term deposits is likely to have played a role. As a result, the seasonally adjusted and annualised three-month rate of (M2-M1) increased to 8½%.

… and in marketable instruments

It was mainly the strong inflows to short-term bank debt securities that were responsible for the sharp increase in marketable instruments (M3-M2), although money market funds and repos recorded discernible increases, too, on balance. However, repo transactions expanded considerably only in January, whereby this increase must be seen as a countermovement to the slump in December. By contrast, repos – which also include secured money market operations via central counterparties – fell again markedly in March. A likely reason for this is the generous supply of liquidity by the Eurosystem in the context of the two three-year refinancing operations.

Strong reduction in monetary capital

The mirror image of the portfolio shifts into M3 components was a sharp decline in the MFI's longer-term financial liabilities vis-à-vis other sectors (monetary capital). Here, notable outflows from long-term time deposits and the sharp decline in bank debt securities with a maturity of over two years were only partially offset by the continued accumulation of capital and reserves. The continued reduction in long-term bank debt securities, roughly half of which was again offset by the purchase of short-term bank debt securities contained in (M3-M2) by the private non-bank sector, reflects the private sector's persistent reluctance with regard to the long-term financing of the banking sector. The rise in the attractiveness of short-term compared with long-term bank debt securities was likely attributable to the – from the investors' viewpoint – reduced risk as a result of the Eurosystem's three-year refinancing operations.

Monetary developments in the euro area *

Changes in € billion, seasonally adjusted

Monetary aggregate in a balance sheet context	2011 Q4	2012 Q1
Monetary aggregate M3 (=1+2-3-4-5)	– 78.5	183.9
Components:		
Currency in circulation and overnight deposits (M1)	4.2	61.4
Other shorter-term deposits (M2-M1)	– 11.3	77.7
Marketable instruments (M3-M2)	– 71.4	44.8
Counterparts		
1. Total credit to non-MFIs in the euro area	49.3	151.7
Credit to general government	70.2	95.1
Credit to private-sector non-MFIs in the euro area 1	– 21.0	56.6
2. Net external assets	– 52.2	– 13.0
3. Central government deposits	41.6	9.9
4. Longer-term financial liabilities to other non-MFIs in the euro area	– 12.3	– 40.8
5. Other counterparts of M3 (residual)	– 46.3	14.3

* Changes for statistical reasons are eliminated. **1** Adjusted for loan sales and securitisation.
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Renewed strong increase in lending to general government in the form of securities

The strongest positive influence on monetary growth exercised by the counterparts came from the banking sector's increased lending to general government. Although this had already increased sharply in the two preceding quarters, it accelerated even more in the first quarter of 2012, which meant that the seasonally adjusted and annualised three-month rate rose from (a revised) 9.5% in December to 12.5% in March. This was caused almost exclusively by commercial banks purchasing securities, while the Eurosystem's purchases of securities virtually ground to a halt in the reporting quarter. In contrast to lending in the form of securities, there was a visible reduction in loans extended by the banking sector to general government in the reporting quarter.

M3 growth was also supported by the perceptible increase in lending to the private sector.

Substantial government bond purchases by Eurosystem and commercial banks

Over the last two quarters, the euro-area banking sector significantly increased credit to general government. In the last quarter of 2011, this increase amounted to €70.2 billion in seasonally-adjusted terms. Credit to general government rose again perceptibly to reach €95.1 billion in the first three months of 2012.

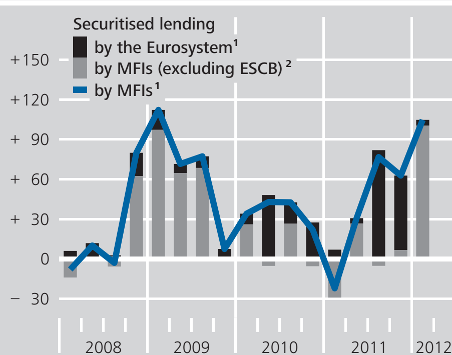
Credit is provided to general government both in the form of loans and through securitised lending, ie through the purchase of government bonds and other debt securities issued by the government. Whereas loans have declined on balance since the beginning of 2011, securities holdings have increased significantly and currently account for almost two-thirds of outstanding loans from the MFI sector to general government.

The chart opposite shows the quarterly seasonally-adjusted changes in securitised lending to general government, broken down into the contribution made by commercial banks and the bond purchases made by the Eurosystem. The increase in the Eurosystem's securitised lending to general government in the second quarter of 2012 was due to the purchases made under the Securities Market Programme (SMP) launched in May 2010. In 2011, the net inflow of €149 billion in securitised lending by the MFI sector to general government was attributable entirely to these purchases by the Eurosystem in the secondary market. Overall, ie including the decrease in loans, the supply of credit from the MFI sector to general government increased by €90 billion in 2011, exceeding the net growth in loans to the private sector by just over €20 billion.

At €4.2 billion, bond purchases by the Eurosystem made only a modest contribution to the increase in the MFI sector's securitised lending to general government in the first three months of 2012. By contrast, commercial banks significantly expanded their securitised lending to general government. In seasonally adjusted terms, they increased their credit to this sector by a total of €100.5 billion. As shown by the non-seasonally adjusted national data, this increase was very largely attributable to Spanish and Italian banks, which purchased almost exclusively domestic government bonds.[1] This development took place alongside the launch of the Eurosystem's three-year refinancing operations and the expansion of the collateral framework, which provided the banking sector with a large volume of additional financing. As well as securitised lending to general government, securitised lending to the private sector also benefited from this, expanding by just under €31 billion in the reporting quarter.

Securitised lending to general government

€ bn, quarterly flows, seasonally adjusted



1 Source: ECB. 2 Source: Bundesbank calculations based on ECB data.

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1 Seasonally adjusted data are not available at country level.

Llending to private sector in the form of securities up, too

This increase was partly characterised by the marked growth in lending to the private sector in the form of securities, which is likewise likely to be linked to the extensive provision of liquidity from the three-year refinancing operations. As of February, commercial banks extended their equity holdings, whereas they had still acquired a large amount of other securities in January. In addition, – over the first quarter as a whole – loans increased markedly too. This development was, however, exclusively attributable to strong inflows in January, which represented a countermovement to the outflows in December. On balance, the seasonally adjusted and annualised three-month rate of loans to the private sector (adjusted for credit sales and securitisations) rose to just under 1%, after just under -1% in December.

Discernible increase in loans to households

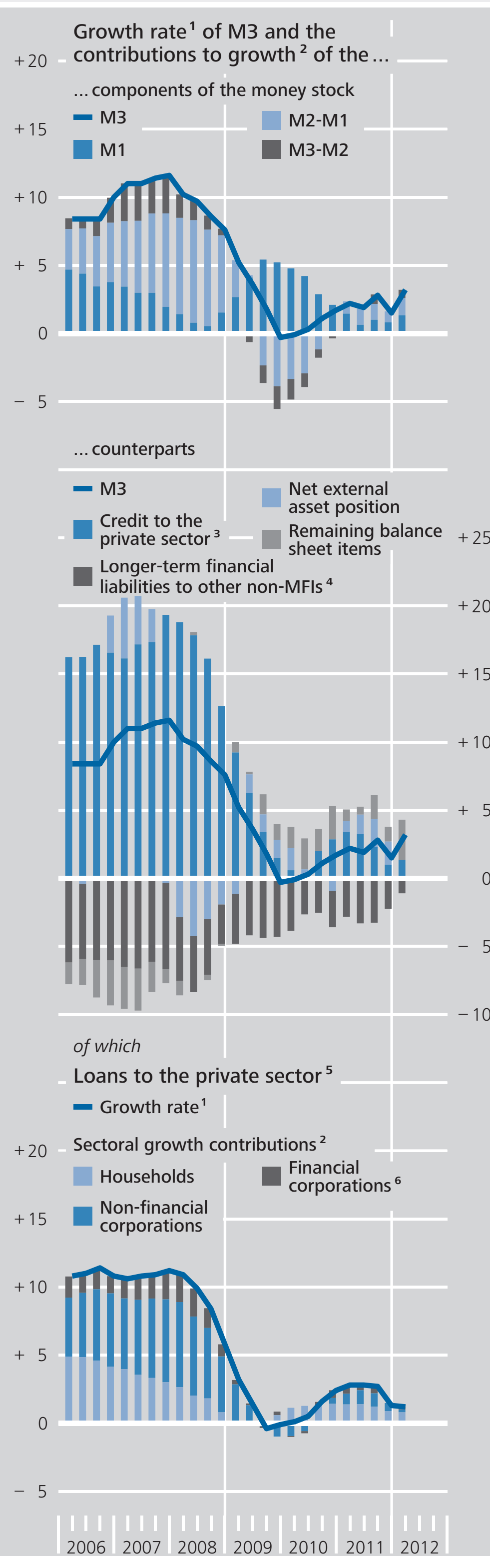
The main cause for this increase were loans from MFIs to households, which once again grew discernibly in the first quarter of 2012. The positive developments were, however, confined to the euro-area core countries, whereas lending to households by banks in the peripheral countries declined perceptibly in some cases against the backdrop, among other things, of continuously high levels of private debt. Supported almost exclusively by loans for house purchase, which continued to benefit from favourable financing conditions and government support schemes in some countries, the seasonally adjusted and annualised three-month rate for loans to households in the euro area (adjusted for loan sales and securitisations) edged up slightly and stood at 1.5% at the end of March.

Loans to financial corporations, too, increased markedly in the reporting quarter. However, a large share of these loans ultimately forms the counterpart to indirect interbank transactions (reverse repos) contained in (M3-M2) and therefore represents no additional provision of funds to the private non-bank sector per se.

Unlike loans to households, loans to non-financial corporations declined slightly in the

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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Slight reduction in loans to non-financial corporations

winter months after they had already fallen appreciably in the preceding quarter. The countermovement to the high outflows in December turned out to be rather weak in January and was substantially overshadowed by the outflows that followed in February and March. Hence, the three-month rate of loans to non-financial corporations (adjusted for loan sales and securitisations) remained in negative territory, yet recorded a seasonally adjusted and annualised increase from -3% to -0.5%. Loans with short and medium-term maturities declined, whereas loans with maturities of over five years experienced growth – as in the preceding quarters. The overall modest extension of loans throughout the euro area is a result of the very heterogeneous developments in loans to non-financial corporations in the individual member states.

Decline in net external asset position has slightly dampening effect

A slight decline in the net external asset position of the banking sector vis-à-vis non-residents also had per se a dampening effect on M3 as the perceptible increase in external liabilities was only partly offset by a rise in external claims.

Monetary developments marked by effects of non-standard monetary policy measures

Analysis of the components and counterparts of M3 clearly shows that monetary developments in the first quarter of 2012 were dominated above all by portfolio shifts by the non-bank sector and the purchase of securities by the banking sector. Both factors reflect the impact of the Eurosystem's non-standard monetary policy measures at least to an extent. Consequently, the sharp increase of M3 in the reporting quarter probably overstates the underlying monetary dynamics. This is confirmed by the divergence between monetary growth and the considerably weaker development in loans to the private sector.

Money based forecasts with balanced inflation risks

Inflation forecasts on the basis of various monetary indicators (monetary aggregates, short-term deposits, loans) currently signal, on average, balanced risks to price stability for the next three years. However, the uncertainty associated with these forecasts remains high.

Renewed tightening of euro-area credit supply conditions …

The Bank Lending Survey (BLS) provides indications of what caused the overall muted development of loans to the non-financial private sector in the reporting quarter. According to the results of the April round, the development of credit supply conditions for the euro area as a whole was again marked by restrictive adjustments in the first quarter of 2012, which were more pronounced for loans to enterprises and for house purchase. However, on the whole, the level of tightening remained considerably below that of the previous quarter. Particularly the standards for loans to enterprises were tightened to a lesser degree.

… and a clear simultaneous reduction in the demand for funds

At the same time, the reduction in the demand for funds reported by credit institutions was perceptibly higher compared with the previous quarter. Banks mainly attributed this to the low financing needs for fixed asset investment in lending to enterprises as well as to weak consumer confidence, the subdued prospects for the housing market and the low propensity to purchase durable consumer goods.

Funding environment improved noticeably

Moreover, the banks reported a noticeable improvement in their funding environment compared with the final quarter of 2011 against the backdrop of the non-standard monetary policy measures. Simultaneously, the negative influence of the sovereign debt crisis on banks' funding conditions declined in the euro area as a whole. In addition, the sovereign debt crisis had only a slightly restrictive effect on credit standards in all the surveyed business areas.

German banks' deposit and lending business with domestic customers

German banks' deposit business regains momentum

Following a slight decline in the previous quarter, the deposit business of German banks regained momentum in the first quarter of 2012. The seasonally adjusted and annualised three-month rate rose to 4½%, thereby continuing the trend of the previous year's first three quarters. The expansion was solely sustained by

short-term maturities, the interest rates of which remained relatively attractive despite slipping slightly in the reporting quarter. Sight deposits and short-term time deposits in particular increased significantly. By contrast, there was a renewed and, in parts, clearly stronger decline in longer-term types of investment. This meant that the portfolio shifts away from long-term to shorter-term deposits that had already been observed in the previous quarter continued at an accelerated pace in the reporting quarter.

Reduction in longer-term deposit types continues

A reduction in longer-term deposit types was recorded across all segments. While savings deposits with an agreed maturity of over three months receded to a similar extent as in the previous quarter, the decline in longer-term time deposits (with a maturity of over two years) accelerated discernibly in the first quarter of 2012. Particularly insurance corporations and other financial intermediaries contributed to this development.

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

German banks' credit to domestic non-banks, however, edged up only slightly in the first quarter of 2012. Their seasonally adjusted and annualised three-month rate stood at just over ½% and was (with around €5.2 billion of just under €5.3 billion) almost exclusively driven by an expansion in lending to domestic general government. Although loans to the domestic private sector grew perceptibly, this increase was offset by lending in the form of securities declining at a similar rate. This reduction was mainly attributable to a decrease in the other financial corporations' capital market debt, which had already been observed for some time. In contrast to this, German banks extended their business with general government with regard to loans and to lending in the form of securities.

Significant expansion in loans to non-financial corporations

Lending to non-financial corporations, too, increased markedly again in the first quarter of 2012, whereby it recovered from its decline in the last quarter of 2011 which had been characterised by a higher level of redemption payments towards the end of the year. Quarter-on-quarter developments were mainly shaped by a strong rise in January which represented a countermovement to the extensive decline in December. The fact that these movements focused on loans with short maturities supports the assumption that borrowers cleaned up their balance sheets to be able to present a lower level of debt at the end of the year. Nevertheless, long-term loans to non-financial corporations also posted a sharp increase in the first quarter of 2012. Particularly savings banks, but also regional banks and credit cooperatives, contributed to the expansion of loans to non-financial corporations. Given a strong negative base effect, the clear expansion of corporate loans in the reporting quarter was not matched by a corresponding increase in the annual growth rate. Instead, it recorded a slight decline in the course of the reporting quarter from 1.3% at end-December to 1.1% at end-March.

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

Changes in € billion, seasonally adjusted

Item	2011 Q4	2012 Q1
Deposits of domestic non-MFIs [1]		
Overnight	12.5	24.9
With agreed maturities		
of up to 2 years	− 7.3	16.4
of over 2 years	− 2.8	− 9.6
Redeemable at notice		
of up to 3 months	− 0.2	4.2
of over 3 months	− 4.1	− 3.2
Lending		
to domestic general government		
Loans	− 7.5	1.5
Securitised lending	− 4.3	3.7
to domestic enterprises and households		
Loans	20.5	5.7
of which to households [2]	1.7	7.9
to non-financial corporations [3]	− 3.2	9.8
Securitised lending	− 7.9	− 5.6

***** 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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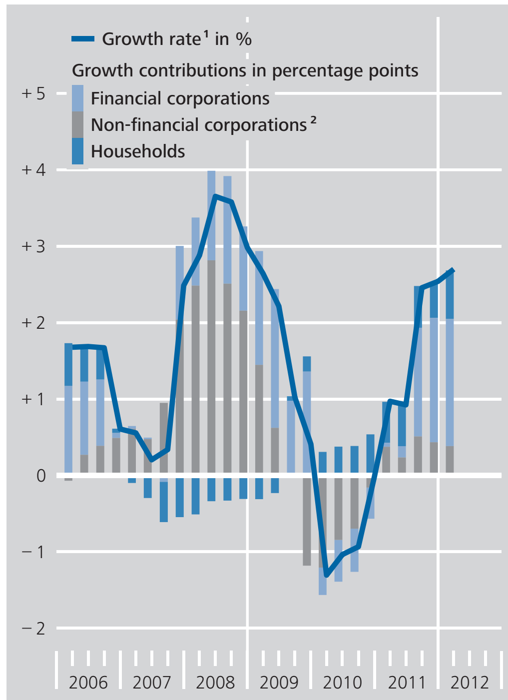
Loans of German banks to selected sectors

Seasonally adjusted, end-of-quarter data



1 Year-on-year rate of change. **2** Non-financial corporations and quasi-corporations.
Deutsche Bundesbank

Discernible growth in loans to households

In addition to loans to non-financial corporations, German banks also increased their loans to domestic households discernibly in the reporting quarter. At just over 2%, in the reporting quarter these loans increased at a rate (seasonally adjusted and annualised) not seen in almost ten years. As with non-financial corporations, growth was mainly attributable to regional banks and credit cooperatives. This was caused by the continued growth in loans for house purchase, a major component of household borrowing – the annualised three-month rate of which accelerated to 1.6% – on the one hand, and by the perceptible increase in consumer loans – the (seasonally adjusted and annualised) growth rate of which climbed from 3.0% at end-December to 5.0% at end-March – on the other hand. Looking at the year as a whole, the growth in loans to households at an annual rate of 1.1% at the end of the first quarter is, however, still to be described as moderate.

Lending policies …

In the first quarter, the German banks that participated in the BLS tightened credit standards minimally on the whole.[1,2] It was only in the case of lending to small and medium-sized enterprises that institutions undertook a slight easing. The restrictive influences in loans to enterprises mainly originated from capital costs, whereas the institutions' good liquidity position and competition within the banking sector had per se an expansive effect on standards. A clearly different development in terms of business area and credit rating category was recorded for loan margins. While the surveyed banks widened the margins on riskier loans to enterprises, they saw no need to adjust the margins for average-risk loans. By contrast, the margins were tightened perceptibly in parts of the retail customer business with the exception of riskier loans for house purchase. All other surveyed credit conditions, however, remained virtually unchanged across all business areas.

… and developments in demand for loans mixed

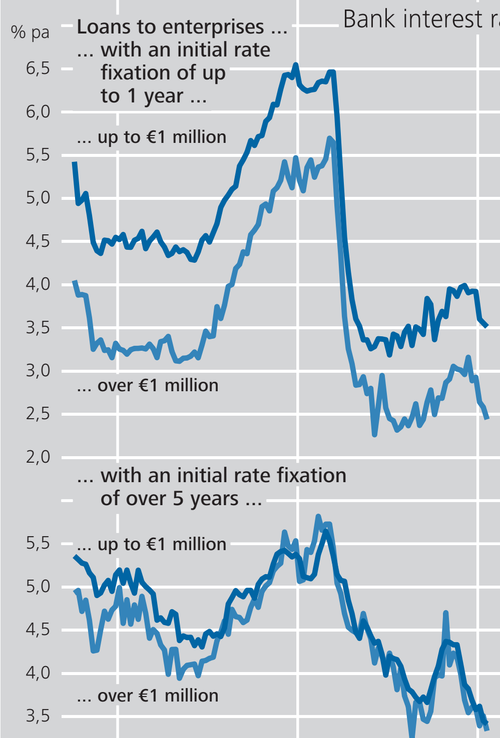
In contrast to lending as reported by all banks for banking statistics purposes, the surveyed institutions at the same time reported unchanged demand for consumer credit as well as a perceptible decline in demand for loans to enterprises in the first quarter of 2012. The reduced demand in loans to enterprises was, according to the information they provided, attributable above all to the enterprises' resorting to internal funds and, to a somewhat lesser extent, to their procuring funds on the capital market. By contrast, the institutions recorded a perceptible increase in demand for loans for house purchase, which they attributed primarily to the consistently robust consumer confidence and the positive outlook for the housing market.

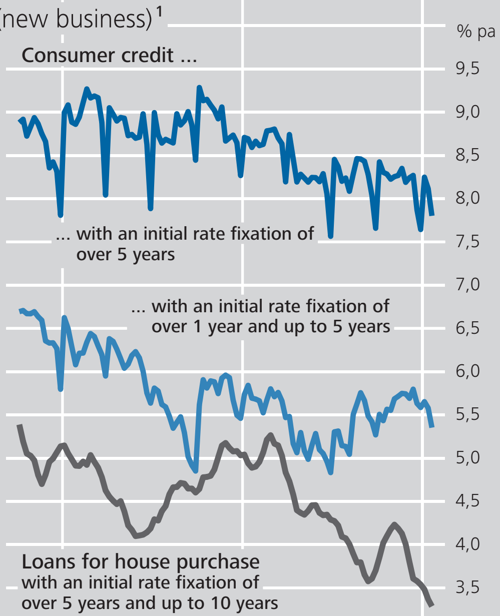
1 The aggregate survey results for Germany may be found at www.bundesbank.de/volkswirtschaft/vo_veroeffentlichungen.en.php.
2 Starting with the April survey, the German sample of the BLS for the euro area was extended to currently 34 surveyed institutions. Following the changes in the German banking sector during the past few years, this enlargement became necessary in order to maintain a high degree of representativeness in the future.

Banking conditions in Germany

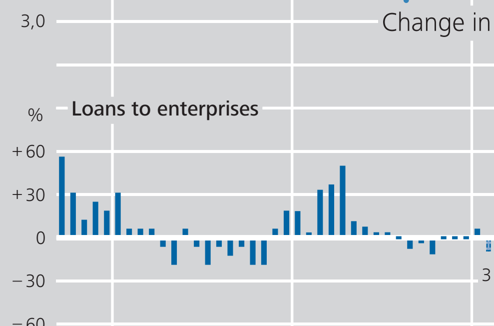
Credit to non-financial corporations | Credit to households

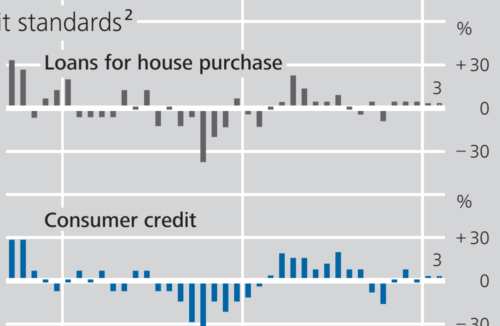
Bank interest rates (new business)[1]



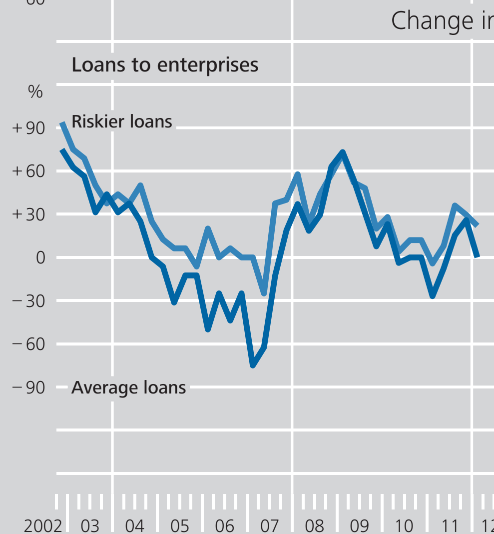


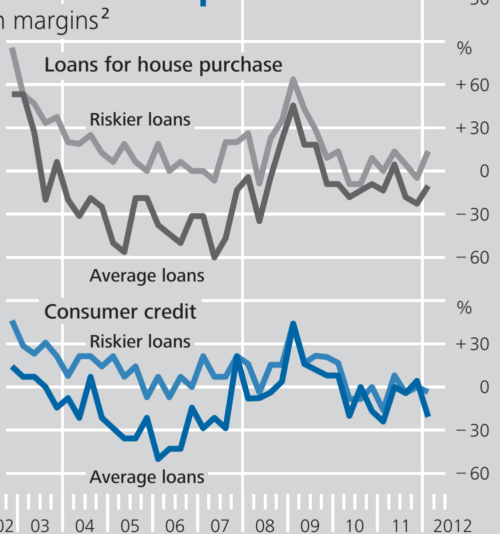
Change in credit standards[2]





Change in loan margins[2]





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 Q2.

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Funding conditions improve

The survey for the first quarter again contained two additional questions on the impact of the financial and sovereign debt crisis on banks' funding conditions and credit standards. According to the answers provided by the German institutions, their access to funding sources improved perceptibly on the whole in the first quarter against the backdrop of the positive developments in the financial markets as a result of the two three-year tenders. This mostly affected access to the securitisation markets and the primary markets for bank bonds. On the whole, however, German banks' current assessment was somewhat more subdued compared to the data from European banks, after they had reported that their situation was deteriorating to a lesser extent in the last two surveys. Furthermore, the German banks indicated that the – in some cases – perceptible recoveries on the European government bond markets were having a positive effect on their funding conditions. However, the sovereign debt crisis had no influence on the credit conditions in the corporate and retail customer business.

Conditions for bank loans deteriorating

In the first quarter of 2012, bank lending rates across all surveyed business sectors continued on the downward path they had set out on in the previous year. Here, the decline in interest rates for loans to enterprises was – at over 40 basis points – about twice as strong for short rate fixation periods as for long periods. Interest rates for loans with long rate fixation periods have been at a historical low since the previous quarter, and stood at an average of 3.3% for large-scale loans and at 3.4% for small-scale loans at the end of the quarter. A similar pattern was recorded in interest rates on loans for house purchase. The decline in interest rates on loans with short rate fixation periods was – at 33 basis points – rather pronounced, whereas interest rates for loans with rate fixation periods of over five years were hardly lowered further and – averaging 3.4% – persisted at a low level. In contrast to the seasonal pattern of the last few years, interest rates for consumer credit with rate fixation periods of up to five years fell again; only the conditions for loans with rate fixation periods of more than five years rose again slightly to 7.8% compared with the end of the year. On the whole, bank lending rates followed the broad downward trend of interest rates in the money and capital markets with no discernible lag.