Monetary policy and banking business

Monetary policy and money market developments

Key interest rates still at record low

The economic outlook for the euro area has once again deteriorated over the past few months. At the same time, inflation forecasts for 2012 and 2013 again had to be revised upwards due to the stronger than expected increases in energy prices and the weaker exchange rate. It is now anticipated that the inflation rate will not decline to values under 2% until sometime next year. Against this backdrop, the ECB Governing Council has not taken any further interest rate policy measures since lowering interest rates at the start of July. This means that the main refinancing rate remains unchanged at the record low of 0.75% set in July. Banks' balances in the deposit facility – as well as their excess reserves on current accounts held at central banks – continue to earn 0% interest. Eurosystem counterparties can obtain overnight credit at 1.5% through the marginal lending facility.

ECB Governing Council decides on new government bond purchase programme

After ECB President Draghi raised the prospect of a new government bond purchase programme following the ECB Governing Council meeting on 2 August 2012, the ECB Governing Council decided at its meeting on 6 September 2012 to implement such a programme (Outright Monetary Transactions – OMTs) and to terminate the previous Securities Market Programme – SMP. According to the Governing Council's decision, the new programme will serve to ensure an orderly transmission of monetary policy (transfer of the policy stance to the real economy) and preserve the singleness of monetary policy in the Eurosystem. OMTs would be used to address severe distortions in government bond markets, which originated, in particular, from investors' unfounded fears regarding the reversibility of the euro.

The new bond purchase programme differs in several aspects from the SMP. Whereas the SMP purchases were not subject to conditionality, the purchase of government bonds from euro-area countries as part of the OMT programme requires that the country in question commits itself to a full EFSF/ESM macroeconomic adjustment programme or to a precautionary programme (Enhanced Conditions Credit Line) and that it complies fully with the respective programme conditionality. The government bond purchases will focus on maturities of between one and three years, and there are no ex ante quantitative limits on the size of OMTs. Furthermore, the programme stipulates that the Eurosystem must accept *pari passu* treatment for its bond purchases compared with other creditors (ie it must waive preferred creditor status), and that the liquidity associated with the purchases must be absorbed through monetary policy operations (sterilisation), as was previously the case with the SMP.

OMT framework subject to conditionality

The Bundesbank remains critical of Eurosystem government bond purchases because of the risks they entail, in particular when they are conducted against the backdrop of high or even increasing sovereign financial requirements. It remains particularly important to maintain a strict separation of fiscal and monetary policy and to avoid the impression of monetary policy being misused for fiscal policy interests. The independence of monetary policy in the euro area ultimately serves to ensure that the Eurosystem can achieve its primary goal of safeguarding price stability in an effective and credible manner.

ECB Governing Council reaches further decisions on the collateral framework

In addition, the ECB Governing Council decided on 6 September 2012 to further expand the collateral framework for monetary policy credit operations in the Eurosystem. Amongst other things, the use of the respective Eurosystem rating threshold – currently a rating of BBB- or comparable ratings – for liabilities of central governments (or for debt instruments or credit claims guaranteed by the central governments)

Money market management and liquidity needs

During the three reserve maintenance periods from 11 July to 9 October 2012, euro-area credit institutions' need for central bank liquidity determined by autonomous liquidity factors fell by €16.6 billion in net terms. This decline was due to a decrease in general government deposits with the Eurosystem, which fell by a total of €37.4 billion compared with period averages. The sum of changes in net foreign assets and other factors had a counterbalancing liquidity-absorbing effect. Taken together, ie adjusted for valuation effects with no impact on liquidity, these fell by €20.6 billion net, thus reducing the liquidity-providing effect generated by general government deposits. The volume of banknotes in circulation remained virtually unchanged over the three maintenance periods, increasing by only €0.2 billion. The minimum reserve requirement also remained virtually unchanged in the review period, increasing by only €0.1 billion net.

The allotment policy employed by the Eurosystem since 2008, under which liquidity-providing open market operations are conducted as fixed-rate tenders with full allotment of the submitted bids, continued to apply in the review period (see table on page 33). Therefore, credit institutions' demand for central bank liquidity was met in full. As was the case in the previous periods, central bank liquidity was significantly higher than the needs resulting from autonomous factors and minimum reserve requirements. The ECB Governing Council's decision taken at its monetary policy meeting on 5 July 2012 to reduce the key interest rates by 0.25% in each case had a particular impact in the period under review. This caused the deposit facility rate to fall to 0.00%, with the standing facility corridor unchanged, which means that for the first time the Eurosystem's deposit facility bore no interest. However, as this zero interest rate has also always applied to excess liquidity, which is not necessary for meeting the reserve requirements, on credit institutions' current accounts, Eurosystem banks no longer had a yield-driven incentive to hold end-of-day surplus liquidity in the deposit facility since the interest rate cut. This was very evident in the period under review, as recourse to the deposit facility dropped sharply by around €465 billion. At the same time, credit institutions' current account holdings rose by almost €427 billion (comparing the period averages in each case, see table on page 31). The increase in current account holdings was lower by comparison due to reduced demand in the main refinancing operations (on balance by €43 billion in total) and in longer-term refinancing operations (on balance by €12 billion in total), even though this was partially compensated by the above-mentioned changes in autonomous factors. At the same time, use of the marginal lending facility was rather low in the period under review (period averages from €0.8 billion to €1.1 billion), although there was a certain daily base amount.

Moreover, as had been announced at the beginning of August 2012, the ECB Governing Council decided on 6 September 2012 on a framework for conducting the Eurosystem's Outright Monetary Transactions (OMTs) in secondary sovereign bond markets. Potential purchases, which are essentially unrestricted in volume, are concentrated at the shorter end of the maturity scale. The objective was that the resulting liquidity-providing effect would be completely neutralised, as was the case with the Securities Markets Programme (SMP). At the same time as these decisions were made, the SMP was terminated; however, the securities in the SMP portfolio will be held to maturity and the liquidity made available through these purchases will continue to be absorbed.

On account of securities reaching maturity and the regular quarterly revaluation, the volume of SMP holdings fell by €1.9 billion in total to €209.5 billion in the period under review. There were no further purchases in this period. Moreover, the weekly tenders to absorb liquidity from SMP purchases continued to soak up the desired volume of liquidity from the market. Furthermore, the holdings from the first Covered Bond Purchase Programme (CBPP), which ended as scheduled at the end of June 2010, fell by €1.7 billion to €54.2 billion in the review period. In contrast, securities holdings under the second Covered Bond Purchase Programme (CBPP2) increased by €2.2 billion to €16.3 billion in total over the same period.

The key interest rate cut adopted at the beginning of July was implemented for the first time in the July-August 2012 maintenance period. The resulting zero percentage rate on the deposit facility caused the use of the facility to fall to €343 billion on average over the period – after €771 billion in the previous period. On the other hand, credit institutions' current account holdings with the Eurosystem rose to €510 billion on average (compared with €112 billion in the previous period), although the aggregate minimum reserve requirement stood at only €107 billion. Excess liquidity – calculated as the sum of the deposit facility and current account holdings less reserve requirement – stood at €746 billion on average (€775 billion in the previous period). Additionally, there was a certain decline in the volume of the main refinancing operations during the reserve maintenance period, after marketable debt instruments issued or guaranteed by the Greek government were temporarily made ineligible for use as collateral in Eurosystem monetary policy operations from the end of July. Overall, the outstanding tender volume (excluding liquidity-absorbing fine-tuning operations) decreased slightly to €1,226 billion on average over the period (compared with €1,236 billion in the previous period). As expected, the key interest rate cut had a considerable effect on overnight rates. EONIA remained fairly constant at 0.115% on average over the maintenance period, just over 63 basis points less than the new main refinancing rate (0.75%). In the previous period, EONIA averaged around 0.33%, ie the difference to the key interest rate was greater at 67 basis points. Secured overnight money on Eurex Repo's Euro GC Pooling (ECB basket) likewise fell short of the rate change by 25 basis points, compared with the previous period. However, the average rate of 0.020% (0.246% in the previous period) remained considerably lower than the EONIA rate. Averaging €22.6 billion, EONIA turnover was down somewhat on the previous period (€24.7 billion), while GC Pooling overnight turnover (ECB basket) rose on average over the period to €7.7 billion, compared with €5.2 billion in the previous period.

In the August-September 2012 reserve maintenance period, demand for liquidity in open market operations remained broadly unchanged. The overall tender volume averaged €1,207 billion, compared with €1,226 billion in the previous period. This meant that there were no changes to the maturity structure, with weekly main refinancing operations accounting for 11% of central bank financing and longer-term refinancing operations for 89%, and with both three-year tenders predominating. As liquidity needs resulting from average autonomous factors receded by around €34 billion compared with the previous period, average excess liquidity increased by €13.4 billion to €759.7 billion. On average, 57% of this amount was channelled into current account holdings and 43% into the deposit facility. There was a slight tendency towards frontloading in this longer 35-day period compared with the previous period, in which an average of 54% of excess liquidity was booked as current account holdings and 46% was put into the deposit facility. EONIA remained virtually unchanged at 0.108% on average, although the EONIA fixing was somewhat higher at around 0.12% at the beginning of

Factors determining bank liquidity[1]

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

Item	2012		
	11 July to 7 Aug	8 Aug to 11 Sep	12 Sep to 9 Oct
I Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors			
1 Banknotes in circulation (increase: –)	– 5.2	+ 0.1	+ 4.9
2 Government deposits with the Eurosystem (increase: –)	+ 8.1	+ 23.7	+ 5.6
3 Net foreign assets[2]	+ 12.2	– 2.1	+ 4.7
4 Other factors[2]	– 32.9	+ 12.5	– 15.0
Total	– 17.8	+ 34.2	+ 0.2
II Monetary policy operations of the Eurosystem			
1 Open market operations			
(a) Main refinancing operations	– 14.7	– 15.4	– 13.0
(b) Longer-term refinancing operations	+ 5.0	– 3.1	– 14.0
(c) Other operations	– 0.3	– 0.3	+ 1.4
2 Standing facilities			
(a) Marginal lending facility	– 1.0	+ 0.0	+ 0.3
(b) Deposit facility (increase: –)	+ 427.5	+ 14.5	+ 23.2
Total	+ 416.5	– 4.3	– 2.1
III Change in credit institutions' current accounts (I + II)	+ 398.7	+ 29.8	– 1.9
IV Change in the minimum reserve requirement (increase: –)	– 0.1	– 0.1	+ 0.1

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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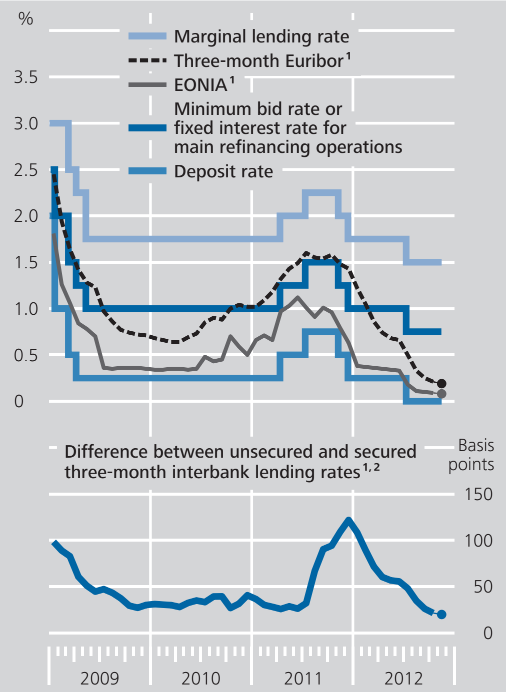
the maintenance period, in keeping with the frontloading, falling to 0.10% at the end of the period. At €21.9 billion, average EONIA turnover remained low. The GC Pooling weighted overnight rate (ECB basket) also dropped at the end of the period, and on the last day of the maintenance period stood at 0.014%; the underlying turnover averaged €8.0 billion for the period.

The September-October 2012 maintenance period was characterised by a continued decline in demand for central bank liquidity. The decline primarily concerned the main refinancing operations, which averaged €118 billion over the period (€131 billion in the previous period). Overall, the outstanding tender volume (excluding liquidity-absorbing fine-tuning operations) fell to €1,180 billion on average over the period (compared with €1,207 billion in July to August). As need for liquidity resulting from autonomous factors remained virtually unchanged compared with the previous period (€409 billion on average), excess liquidity fell by €23 billion to €736 billion on average compared with the previous period. At the same time, the tendency to hold increasingly more excess liquidity as current account holdings continued (58.5%), although considerable use was still made of the deposit facility (41.5%). Banks identified, *inter alia*, internal management mechanisms as the reason for this. EONIA fell slightly to 0.095% on average over the period (compared with 0.108% in the previous period); at the end of the quarter (end of September) the rate rose only marginally to 0.107%, the highest value for that period. EONIA turnover increased to €25.4 billion (compared with €21.9 billion in the previous period), which may have resulted from the slight decrease in excess liquidity. Secured overnight money, which is traded at a considerably lower rate, also fell. The rate for the GC Pooling ECB basket averaged 0.014% over the period, indicating a drop compared with the previous period of around 1 basis point. The corresponding turnover at GC Pooling increased again to approximately €8.5 billion on average over the period.

Money market interest rates in the euro area



1 Monthly averages. **2** Three-month Euribor less three-month Eurepo. • Average 1 to 15 November 2012.
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has been suspended on the condition that the countries are eligible for OMTs or commit to an EU/IMF programme and that, in the Governing Council's estimation, they comply with the attached conditionality.

Securities holdings from monetary policy purchase programmes down slightly

In the past, sovereign bonds were not purchased as part of OMTs. Securities held under the Eurosystem Securities Market Programme (now discontinued) decreased to €208.5 billion due, in particular, to a redemption in August. Under the second Covered Bond Purchase Programme (CBPP2), on 31 October 2012, the Eurosystem had accumulated a total securities volume of just over €16.4 billion. The initially targeted total nominal amount of €40 billion was therefore not fully exhausted. At the same time, securities from the first Covered Bond Purchase Programme (CBPP) reached maturity. Thus, on balance, the total amount of securities held as part of monetary policy programmes decreased slightly from the beginning of the third quarter.

Overall, slight decrease in monetary policy refinancing volume after previous peaks

After being almost on par with previous record levels, at around €1.2 billion in the summer months, the monetary policy refinancing volume provided by the Eurosystem decreased somewhat of late. On the one hand, this can be traced back to certain improvements in the financial situation of banks in euro-area countries that are particularly affected by the financial and sovereign debt crisis. This was reflected temporarily in a slight decline in the still very high level of TARGET claims and liabilities of some national central banks. On the other hand, other euro-denominated Eurosystem claims on credit institutions in the euro area – which are not counted as monetary policy operations and also comprise Emergency Liquidity Assistance (ELA) – increased in part, so that the decrease in the monetary policy refinancing volume is likely to overstate the improvement in the financing situation of the banking system in the euro area.

Overall, the banking system's surplus liquidity – measured in terms of average recourse to the deposit facility plus average excess reserves on current accounts held at central banks, most recently standing at around €678 billion –, also decreased somewhat on average over the maintenance period from 10 October to 13 November 2012, compared with previous peak levels.

Banks report significantly lower rates for unsecured three-month money

The unsecured overnight rate EONIA, which is calculated on the basis of actual transactions carried out by a panel of banks, stood at approximately 0.13% directly after the key interest rate decision came into effect at mid-July and decreased to the rate of 0.8% of late. The spread between EONIA and the rate on the deposit facility is now almost the same as the spread observed immediately after the key interest rate cut. The survey-based (Euribor) rate for unsecured three-month money fell sharply at first in July after the key interest rate reduction, followed by a noticeably more subdued drop to 0.19% of late. Compared with the start of the third quarter, the rate decreased by around 46 basis points. Since the key inter-

Open market operations of the Eurosystem*

Value date	Type of transaction[1]	Maturity in days	Actual allotment in € billion	Deviation from the benchmark in € billion[2]	Marginal rate/fixed rate %	Allotment ratio %	Weighted rate %	Cover ratio[3]	Number of bidders
11.07.2012	MRO (FRT)	7	163.7	763.2	0.75	100.00	–	1.00	90
11.07.2012	FTO (–)	7	– 211.5	–	0.03	66.36	0.02	2.01	95
11.07.2012	S-LTRO (FRT)	28	24.4	–	0.75	100.00	–	1.00	27
18.07.2012	MRO (FRT)	7	156.8	1171.3	0.75	100.00	–	1.00	98
18.07.2012	FTO (–)	7	– 211.5	–	0.02	54.62	0.02	2.08	78
25.07.2012	MRO (FRT)	7	130.7	1545.7	0.75	100.00	–	1.00	98
25.07.2012	FTO (–)	7	– 211.5	–	0.02	45.30	0.01	1.88	69
26.07.2012	LTRO (FRT)	98	8.5	–	[4] 0.75	100.00	–	1.00	36
01.08.2012	MRO (FRT)	7	132.8	979.8	0.75	100.00	–	1.00	97
01.08.2012	FTO (–)	7	– 211.5	–	0.02	15.04	0.01	2.19	72
08.08.2012	MRO (FRT)	7	133.4	327.4	0.75	100.00	–	1.00	87
08.08.2012	FTO (–)	7	– 211.5	–	0.01	73.61	0.01	1.99	67
08.08.2012	S-LTRO (FRT)	35	25.2	–	0.75	100.00	–	1.00	28
15.08.2012	MRO (FRT)	7	130.6	456.6	0.75	100.00	–	1.00	86
15.08.2012	FTO (–)	7	– 211.5	–	0.01	55.97	0.01	1.98	58
22.08.2012	MRO (FRT)	7	131.2	483.6	0.75	100.00	–	1.00	91
22.08.2012	FTO (–)	7	– 211.5	–	0.01	51.04	0.01	2.11	57
29.08.2012	MRO (FRT)	7	131.5	495.0	0.75	100.00	–	1.00	92
29.08.2012	FTO (–)	7	– 209.0	–	0.01	53.21	0.01	2.17	56
30.08.2012	LTRO (FRT)	91	9.7	–	[4] …	100.00	–	1.00	36
05.09.2012	MRO (FRT)	7	126.3	338.3	0.75	100.00	–	1.00	84
05.09.2012	FTO (–)	7	– 209.0	–	0.01	51.04	0.01	2.21	57
12.09.2012	MRO (FRT)	7	130.3	303.8	0.75	100.00	–	1.00	80
12.09.2012	FTO (–)	7	– 209.0	–	0.01	48.91	0.01	2.07	58
12.09.2012	S-LTRO (FRT)	28	13.8	–	0.75	100.00	–	1.00	26
19.09.2012	MRO (FRT)	7	119.8	344.8	0.75	100.00	–	1.00	84
19.09.2012	FTO (–)	7	– 209.0	–	0.01	49.84	0.01	2.24	59
26.09.2012	MRO (FRT)	7	117.4	315.4	0.75	100.00	–	1.00	85
26.09.2012	FTO (–)	7	– 209.0	–	0.01	62.98	0.01	1.85	49
27.09.2012	LTRO (FRT)	84	18.7	–	[4] …	100.00	–	1.00	55
03.10.2012	MRO (FRT)	7	102.9	271.4	0.75	100.00	–	1.00	84
03.10.2012	FTO (–)	7	– 209.0	–	0.01	56.14	0.01	2.01	56

* For more information on the Eurosystem's operations from 11 April 2012 to 10 July 2012, see Deutsche Bundesbank, Monthly Report, August 2012, p 27. **1** MRO: main refinancing operation, LTRO: longer-term refinancing operation, S-LTRO: supplementary longer-term refinancing operation, FTO: fine-tuning operation (+: liquidity providing operation, –: liquidity absorbing operation), FRT: fixed-rate tender. **2** Calculation according to publication after MRO allotment. **3** Ratio of total bids to the allotment amount. **4** The interest rate corresponds to the average minimum bid rate or main refinancing rate of the MROs conducted over the life of this operation (may be rounded to two decimal places in the table).

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est rate decision was made in July, banks participating in the Eurepo panel have quoted, on average, rates of around -0.01% for money market transactions backed by the best collateral. Overall, the spread between unsecured and secured, survey-based money market rates has continued to narrow considerably compared with the previous quarter. However, in light of the still heterogeneous and segmented nature of the interbank money markets, the interpretation of this spread as being a representative risk premium remains subject to considerable reservations.

Monetary developments in the euro area

Monetary dynamics remain moderate

On balance, the broad monetary aggregate (M3) experienced continued moderate growth in the third quarter of 2012, with monthly flows still characterised by increased volatility. Monetary expansion was supported in the months July to September by further portfolio shifts by the money-holding sector in favour of sight deposits and short-term savings deposits. On the counterparts' side, the continued rise in bank lending to domestic general government bolstered monetary growth. In contrast, lending to the domestic private sector in the euro area

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

Changes in € billion, seasonally adjusted

Assets	2012 Q3	2012 Q2	Liabilities	2012 Q3	2012 Q2
Loans to non-MFIs in the euro area	− 7.4	5.0	Central government deposits	15.1	− 24.5
of which			Monetary aggregate M3	59.4	31.4
General government	− 5.6	26.4	*of which:* Components		
Private non-MFIs[1]	− 1.8	− 21.4	Currency in circulation and overnight deposits (M1)	129.7	38.7
Lending in the form of securities to non-MFIs in the euro area	− 11.9	− 35.0	Other shorter-term bank deposits (M2-M1)	− 38.8	1.1
of which			Marketable instruments (M3-M2)	− 31.5	− 8.4
General government	45.2	19.5	Monetary capital	− 23.1	− 68.4
Private non-MFIs	− 57.1	− 54.5			
Net external assets	24.5	− 25.3			
Other counterparts of M3	46.2	− 6.2			

* Changes for statistical reasons eliminated. **1** Adjusted for loan sales and securitisation.
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remained weak for the fourth consecutive quarter. This decoupling is likewise reflected in the annual growth rates. While growth in M3 sank from just over 3.0% in the second quarter to 2.7% in the third quarter owing to a base effect, the annual interest rate for lending (adjusted for loan sales and securitisation) to the domestic private sector fell in this period from 0.1% to -0.4%.

Pronounced increase in sight deposits owing to portfolio shifts

With regard to the individual components, the increase in the M3 aggregate in the third quarter is solely attributable to the narrow money aggregate (M1). The seasonally adjusted and annualised three-month rate saw a dramatic increase from just over 3% at the end of July to 11% at the end of September. This was due to a pronounced increase in sight deposits across almost all sectors. This can be traced back in part to portfolio shifts, which – against the backdrop of high uncertainty and low interest rates – highlight the money-holding sector's preference for highly liquid deposits. Inflows to sight deposits in the quarter under review reached a level comparable to the period that followed the collapse of Lehman Brothers.

In contrast, a reduction in other short-term deposits …

In contrast, the reduction in other short-term bank deposits (M2-M1) curbed monetary developments in the third quarter. The considerable outflows out of (M2-M1) can be attributed to shifts from short-term time deposits to sight deposits, which were made in particular by financial and non-financial corporations. On the other hand, it was predominately households that continued to build up short-term savings deposits. This behaviour was most prevalent in countries where this form of investment benefitted from tax incentives or comparatively attractive interest rates.

… and in marketable financial instruments

Furthermore, the substantial drop in marketable financial instruments (M3-M2) dampened monetary developments in the third quarter. Against the backdrop of a low interest rate environment, the money-holding sector sold money market fund shares. Moreover, short-term bank debt securities decreased noticeably. In contrast, the decline in repurchase agreements (repos) that was observed in the previous quarters, particularly with other financial intermediaries, came to a standstill in the months from July to September.

With regard to the development of marketable instruments, it should be noted that repos (and reverse repos) which are concluded between MFIs and central counterparties have been excluded from the calculation of M3 and its counterparts since August 2012. The reason for this is that these agreements usually concern secured money market transactions between banks, ie the central counterparty merely acts as an intermediary. Thus, these transactions, for the most part, do not involve an inflow to the money-holding sector and are therefore irrelevant for the monetary analysis. It was necessary to adjust the M3 data for such repos as they latterly had a substantial impact on short-term monetary and credit developments. The affected time series were revised back to June 2010.[1]

M3 growth bolstered by considerable rise in credit to general government, …

MFI credit to domestic general government made the most significant contribution to growth in M3 in the months from July to September. Their seasonally adjusted and annualised three-month rate, which stood at 5% at the end of the third quarter, after reaching almost 6% at the end of the previous quarter, continued its strong growth, which has been evident for some time now. Securities of sovereign issuers were the main drivers of monetary growth in the reporting quarter; German banks in particular and, to a lesser extent, Greek banks increased their holdings of domestic securities. In contrast, loans to the public sector experienced a slight decrease.

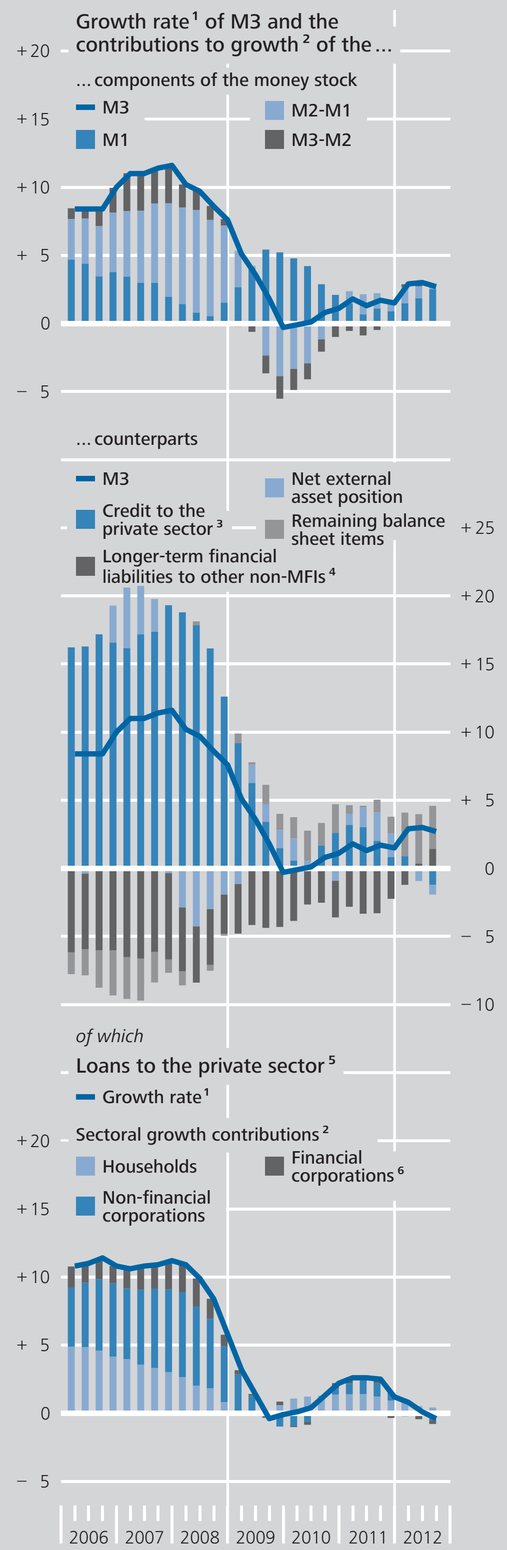
… perceptible outflow of monetary capital …

MFIs' longer-term financial liabilities towards other domestic sectors (monetary capital) also had a notably positive effect on monetary growth. As already observed in the previous three quarters, holdings of monetary capital fell despite MFIs' continued expansion of capital and reserves. This was driven by the reduction in long-term time deposits, which, alongside shifts in institutional investors' portfolios, was linked to the unwinding of previous securitisation deals. In contrast, the decline in long-term bank debt securities in the euro area, observed since autumn 2011, came to a complete standstill in the third quarter. Despite this, there was a continued net redemption of debt securities in those countries that have been particularly affected by the crisis.

1 For details, see The adjustment of monetary statistics for repurchase agreement transactions with central counterparties, Monthly Bulletin, ECB, September 2012, pp 28-31.

Components and counterparts of the money stock in the euro area

Seasonally adjusted, end-of-quarter data



1 Year-on-year change in per cent. 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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… and moderate rise in the net external asset position

Monetary development was also strengthened by a moderate increase in the net external asset position of the MFI sector vis-à-vis non-residents. This development was driven by a clear decrease in external liabilities, which was counterbalanced by a smaller decline in external claims.

Strong decline in securitised lending to private sector, …

As in the previous quarter, MFI credit to the domestic private sector was the M3 counterpart position that had the strongest dampening effect on monetary growth in the summer months. This was caused by the unusually strong decline in privately-issued securities, in particular by other financial corporations. This decline resulted mainly from banks' unwinding of previous securitisation deals and therefore does not entirely reflect a lower level of commercial banks' lending to the domestic private sector.

… loans to the private sector stagnant; however, development is very varied.

MFI loans to the domestic private sector, which experienced a marked decline in the second quarter, stagnated in the months July to September. Nonetheless, lending patterns continued to vary greatly within the euro area, with a rise recorded for member states which had retained their high credit rating and further net redemptions for the countries which have been hit hardest by the debt crisis. Loan developments in these countries are not only being dampened by the weak economy but also by major structural adjustment processes.

Marked decline in loans to non-financial corporations, …

The effects of the economic slowdown, of increased uncertainty among borrowers and of balance sheet consolidation in several euro-area countries were evident in the third quarter, particularly in loans to non-financial corporations. Their seasonally adjusted and annualised three-month rate (adjusted for loan sales and securitisation) fell from 0% at the end of June to -1½% at the end of September. All maturity ranges were affected by the decline; loans with medium-term maturities experienced a particularly sharp drop.

… moderate increase in loans to households

Loans to euro-area households increased only moderately in the third quarter. The seasonally adjusted and annualised three-month rate (adjusted for loan sales and securitisation) rose slightly from just over 0% at the end of June to just under ½% at the end of September. As in the previous two quarters, the increase was attributable to loans for house purchase, which is most likely due to the still favourable financing conditions. In contrast, consumer borrowing continued its downward trend. Thus, lending to the domestic private sector in the quarter under review was substantially bolstered only by loans to financial corporations (since August 2012 adjusted for MFI reverse repos with central counterparties, see footnote on page 35).

Forecasts based on monetary indicators signal no particular risks to price stability

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

German banks' deposit and lending business with domestic customers

Growth in deposit business slows considerably

Although deposits continued to increase in net terms across all categories, German banks' deposit business lost considerable momentum in the third quarter after strong growth in the first six months of the year. The reduced momentum in deposit growth was largely attributable to a strong decline in short-term time deposits, which had recorded substantial inflows in the first half of the year. Although short-term time deposits fell across all sectors, this decline was most pronounced for households. In contrast, sight deposits continued to grow unabated in the quarter under review. As longer-term deposits at the same time experienced another distinct decline, portfolio shifts from long-term to shorter term deposits continued on balance during the third quarter.

In the case of longer-term deposits, time deposits with a maturity of over two years fell significantly once again. This decline was partly

Renewed decline in longer-term deposits, primarily in favour of sight deposits

due to continued shifts in households' and non-financial corporations' portfolios in favour of overnight deposits. Insurance companies and other financial institutions also withdrew time deposits, however, without at the same time increasing their sight deposits. Savings deposits with longer periods of notice also fell significantly in the third quarter of the year. Movements in this market segment are usually almost exclusively attributable to households' portfolio decisions.

Strong growth in banks' lending to domestic non-banks

Lending by German banks to domestic non-banks maintained the trend it has pursued since the beginning of the year, and noticeably gained momentum in the quarter under review. The (seasonally adjusted and annualised) growth of almost 2½% compared with the previous quarter was primarily attributable to a renewed considerable increase in loans to the private sector. In addition, banks increased their holdings of privately-issued securities, which they had scaled back in the previous five quarters. Lending to domestic general government returned to normal after a substantial rise in the previous quarter and increased noticeably in net terms. The decrease in loans contrasted with substantial growth in lending to general government in the form of securities.

Marked increase in loans to non-financial corporations

The considerable expansion in lending to the private sector was largely driven by an increase in loans to non-financial corporations and households. By comparison, loans to financial corporations only went up marginally on balance in the third quarter.[2] In contrast to the strong outflows in the euro area, Germany once again saw a noticeable expansion in loans to non-financial corporations in the quarter under review. Given the low level of investment in equipment, this indicates modified financing behaviour, or an increased acquisition of financial assets by corporations, which could be linked to the even more favourable interest rates on lending. The increase was primarily concentrated on short and long-term maturities; loans with medium-term maturities fell slightly. This renewed growth was driven by co-operative banks and savings banks in particular; the contribution of Landesbanken decreased somewhat compared with the previous quarter. While the seasonally adjusted and annualised three-month rate for loans to non-financial corporations rose by 50 basis points in the reporting quarter to 3% at the end of September, the annual growth rate moved up only slightly to 2.2%, compared with 1.9% at the end of June.

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

Changes in € billion, seasonally adjusted

Item	2012 Q2	2012 Q3
Deposits of domestic non-MFIs 1		
Overnight	42.9	42.0
With agreed maturities		
of up to 2 years	11.5	– 19.8
of over 2 years	– 7.0	– 8.8
Redeemable at notice		
of up to 3 months	3.7	4.7
of over 3 months	– 0.8	– 3.3
Lending		
to domestic general government		
Loans	10.4	– 9.8
Securitised lending	1.0	14.0
to domestic enterprises and households		
Loans	9.4	10.0
of which to households 2	4.0	3.9
to non-financial corporations 3	5.1	6.0
Securitised lending	– 5.1	4.0

* 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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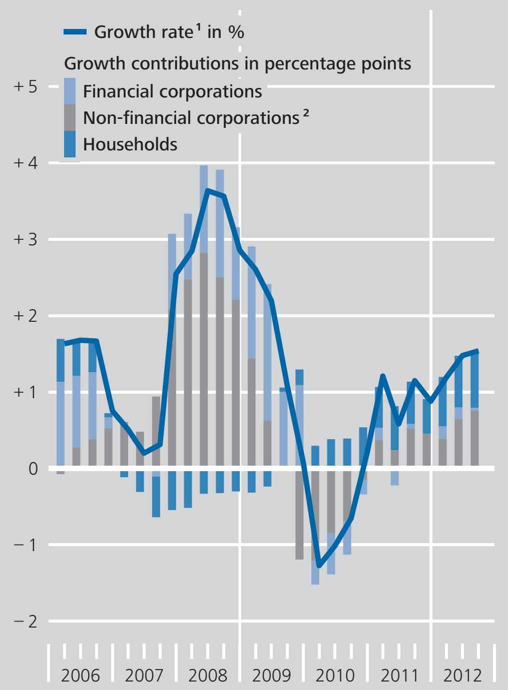
Discernible growth in loans to households, solely driven by lending for house purchase.

In addition to their loans to non-financial corporations, German banks also increased their loans to domestic households on balance in the reporting quarter. However, at 1%, the seasonally adjusted and annualised growth was once again very low. As for the euro-area aggregate, growth in lending was solely driven by a renewed increase in loans for house pur-

2 As is the case for the euro area as a whole, bank loans to financial corporations in Germany for the period from June 2010 onwards are adjusted for reverse repo transactions with central counterparties. For details, see pp 34-35.

Loans of German banks to selected sectors

Seasonally adjusted, end-of-quarter data



1 Year-on-year rate of change. **2** Non-financial corporations and quasi-corporations.
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chase, which rose slightly to a seasonally adjusted and annualised rate of 2%. In contrast, consumer credit saw a distinct decline, which was primarily due to a drop in longer-term loans. The rise in lending to households was attributable, for the most part, to savings banks, regional and cooperative banks as well as commercial banks, while big banks again scaled back business slightly in this area. The 12-month rate for loans to households edged up marginally from 1.1% in the previous quarter to 1.2%.

German banks' credit standards vis-à-vis businesses tightened slightly

According to the latest findings of the Bank Lending Survey (BLS), lending by German banks in the third quarter of 2012 was characterised by restrictive adjustments. Overall, this led to a slight tightening of credit standards for transactions with non-financial corporations and to a marked tightening of credit standards for lending to large corporations. According to the institutions surveyed, the restrictive adjustments resulted from higher capital costs, a deterioration in the general economic outlook as well as sector and company-specific factors. In addition, banks' credit conditions were more restrictive on the whole. For this reason, institutions widened their margins significantly for riskier loans and to a lesser degree for loans to borrowers of average creditworthiness, thus continuing the ongoing trend of intensified differentiation in risk pricing, which has been noted since the third quarter in 2009. Moreover, banks tightened conditions for loan covenants as well as for credit accounts and credit collateral. Only non-interest charges and requirements regarding loan maturities remained largely unchanged on balance.

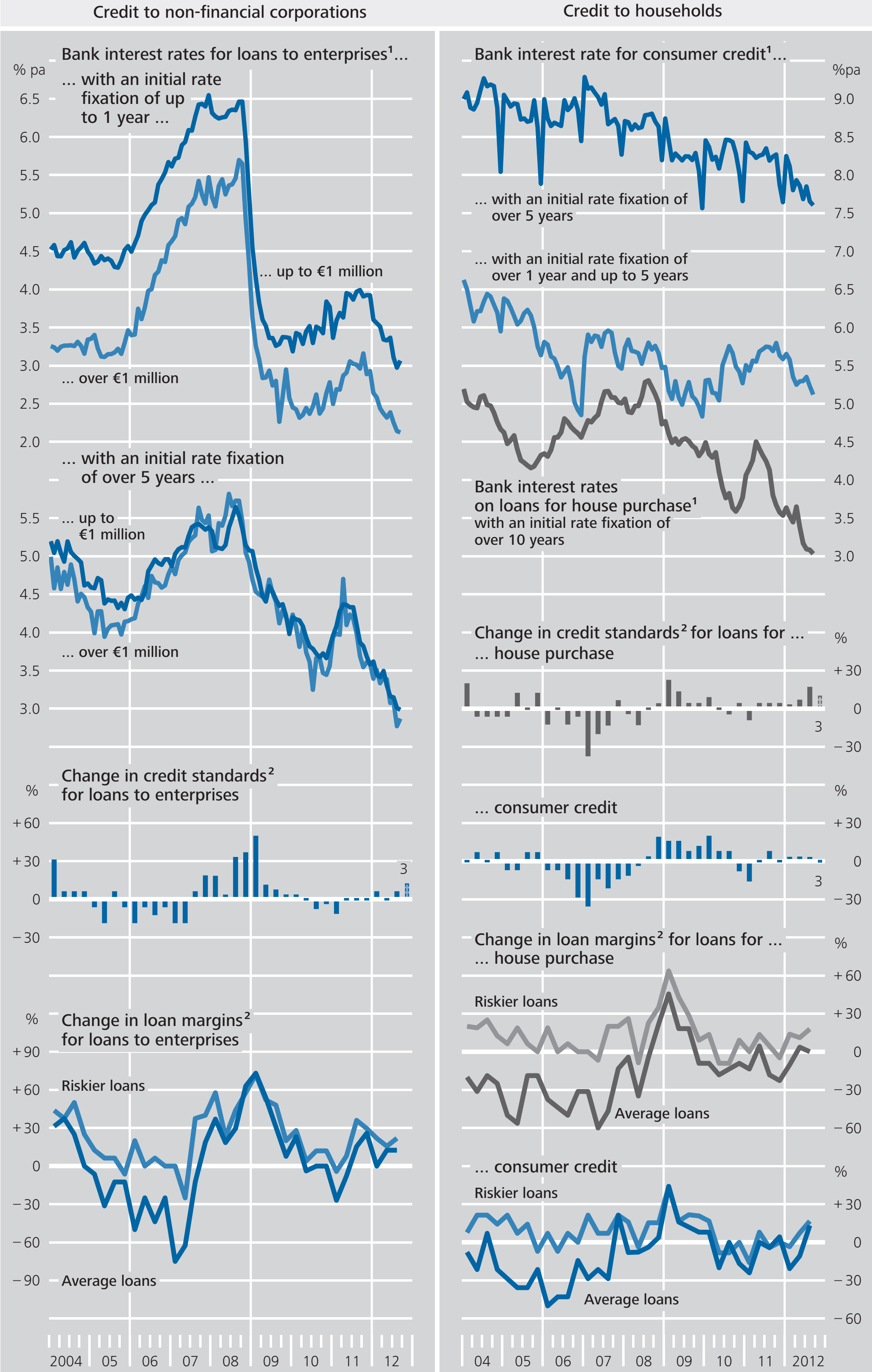
Noticeable stiffening in standards for private housing loans

In lending to households, the institutions participating in the survey tightened their credit standards somewhat for housing loans. According to the information they provided, the positive outlook in the housing market on its own had little expansionary effect. In contrast, the more stringent requirements for repayment rates, designed to limit loan maturities and contain interest rate risk, had a restrictive effect on credit standards. On the other hand, they saw no need to adjust customer credit standards. Nevertheless, the margins in both credit categories and in the riskier segment in particular were widened noticeably.

Trend increase in demand for private housing loans continues

Different developments in demand for credit were observed in the individual business areas. While demand for corporate loans at the surveyed banks decreased marginally – contrasting with lending reported by all banks as part of the banking statistics – demand for consumer loans increased slightly, again in contrast with the banking statistics as a whole. Furthermore, survey participants reported that the sustained trend towards growth in demand for housing loans since the beginning of the sovereign debt crisis continued in the third quarter of 2012. Banks attributed this primarily to the continued highly optimistic outlook on the housing market, persistently strong consumer confidence as well as low interest rates.

Banking conditions in Germany



1 New business. 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 Q4.

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Special questions on the funding situation and effects of the sovereign debt crisis

The Bank Lending Survey contained two additional questions regarding the impact of the financial and sovereign debt crisis on the banks' funding conditions and credit standards. The institutions participating in the survey reported that their funding situation showed a distinct improvement overall in the third quarter. This was attributed primarily to the favourable development in short-term deposits as well as in medium to long-term debt securities. Furthermore, banks active in this area reported a considerable recovery in the securitisation market for corporate and housing loans. According to the survey participants, only refinancing using longer-term customer deposits was more difficult than in the previous quarter. By contrast, the sovereign debt crisis had no impact on the German banks' funding situation or credit standards in the previous quarter.

Lending policies in the euro area tightened

The euro area, too, saw an overall tightening of credit standards in the third quarter. This was due both to restrictive bank-related factors and to a deterioration in the institutions' perception of risk. At the same time, demand as reported by the institutions participating in the October survey fell once again across all surveyed sectors, although official statistics indicated a slight rise in loans for house purchase in the euro area. In addition, European institutions reported an overall improvement in their funding situation, which was clearly noticeable in medium to long-term bank debt securities. In contrast, the sovereign debt crisis only had a slightly negative effect on funding conditions, which, however, moderated slightly compared with the previous quarter. By and large, the crisis had no impact on credit standards.

Bank interest rates in Germany down again

The third quarter saw a renewed decline in bank lending rates across almost all business areas, maturities and volumes, thus reflecting the general downward trend in interest rates on the money and capital markets. Interest rates for long-term loans to corporations stood at 3.0% for small-scale loans and at 2.9% for large-scale loans; this was roughly 20 basis points lower than at the end of June. In addition, conditions for private loans for house purchase with an initial rate fixation period of over ten years fell once again by 14 basis points, reaching a new record low of 3.0% since the statistics were introduced in 2003. Long-term consumer loans were also more favourably priced: the interest rate fell by 8 basis points to 7.6% compared with the previous quarter.