Monetary policy and banking business

Monetary policy and money market developments

Main refinancing rate reduced to new all-time low

While the Governing Council of the ECB left key interest rates unchanged in the third quarter, declining price pressures and the subdued outlook for inflation prompted it to cut the main refinancing rate by another 25 basis points to 0.25% at its meeting on 7 November 2013. The interest rate on the marginal lending facility was also lowered by 25 basis points to 0.75%, while the rate on the deposit facility remains unchanged at 0.00%. Thus, for the first time since spring 1999, the interest rate corridor around the main refinancing rate is asymmetrical.

The ECB Governing Council's latest interest rate decision was based on the assessment that the surprisingly sharp drop in the Harmonised Index of Consumer Prices (HICP) inflation rate to 0.7% in October signalled declining price pressures in the euro area over the medium term. Moderate growth in the monetary aggregates and a continued weak lending trend also point in the same direction. At the same time, the inflation expectations for the private sector signalled by the available indicators reveal that economic agents expect the inflation rate to return to values of close to 2% in the medium to long term. The accommodative monetary policy stance will continue to support the gradual recovery in economic activity observed since the spring.

ECB Governing Council confirms forward guidance on its future monetary policy stance

In addition, as in the preceding monetary policy meetings, the ECB Governing Council confirmed on 7 November its forward guidance on the future development of the ECB key interest rates, which was first communicated on 4 July. Accordingly, the ECB Governing Council still intends to keep key interest rates at present or lower levels for an extended period of time. This statement is based on the assessment that the subdued outlook for inflation extends into the medium term, and is therefore entirely consistent with the Eurosystem's monetary policy strategy.

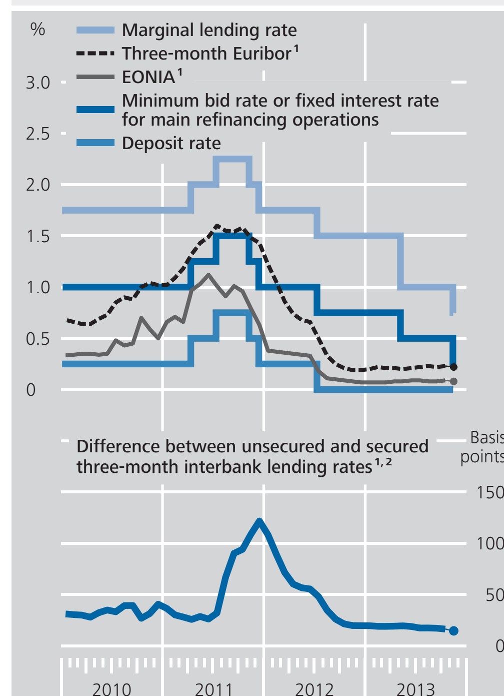
Full allotment for main refinancing operations prolonged once again

Besides cutting its key interest rates, the ECB Governing Council decided to continue to conduct the Eurosystem refinancing operations which are currently offered on a regular basis as fixed-rate tenders with full allotment at least until the end of the second quarter of 2015 – ie one year longer than guaranteed previously.

ECB Governing Council publishes ELA procedural rules

In line with a decision by the ECB Governing Council, on 17 October 2013 the ECB published details on the procedure for the provision of emergency liquidity assistance (ELA) with the aim of providing the public with clearer information on the role played by the ECB Governing Council in the provision of ELA by the Eurosystem national central banks (NCBs). ELA is defined as the provision of central bank money

Money market interest rates in the euro area



Source: ECB. **1** Monthly averages. **2** Three-month Euribor less three-month Eurepo. • Average 1 to 13 November 2013.
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Money market management and liquidity needs

Liquidity provision to credit institutions in the euro area was still well above the calculated liquidity needs during the three maintenance periods under review, from 10 July to 8 October 2013. However, excess liquidity (deposit facility plus current account holdings minus the reserve requirement) fell markedly from an average of €274 billion in the period before the start of the period under review to €224 billion in the September-October period; in this context, the significance of the deposit facility for the holding of excess liquidity likewise decreased continuously, its share declining from one-third in the first maintenance period of the period under review to around one-quarter in the last one. The share of excess reserves held in central bank current accounts rose at the same time as a result. The decline in excess liquidity stemmed mainly from early repayments of liquidity provided in the three-year tenders totalling €35.7 billion as well as from reduced demand in the main refinancing operations and maturities under the securities purchase programmes initiated as part of the ECB's monetary policy. On the other hand, the average autonomous factors changed little by comparison, although there were, in some cases, strong fluctuations within the individual maintenance periods. Liquidity-providing open market operations continued to be carried out as fixed-rate tenders with full allotment of the submitted bids (see table on page 26). Secured overnight rates on GC Pooling (ECB basket) rose somewhat on average vis-à-vis the previous three maintenance periods (from 0.054% to 0.063%), approaching the more stable EONIA (which averaged 0.085%). Secured overnight money reacted more strongly than EONIA to the change in liquidity conditions, although both continued to take their bearings primarily from the deposit facility rate of 0% given the generous liquidity conditions.

Overall, liquidity needs stemming from autonomous factors in the three maintenance periods were almost unchanged, rising only slightly by €1.1 billion in net terms. Although general government deposits fell by €12.4 billion, leading to a decrease in demand for central bank liquidity, this effect was more than offset by the remaining autonomous factors. Banknotes in circulation rose on balance by €9.0 billion, compared with a marginal increase of only €0.2 billion in the corresponding 2012 period. The sum of changes in net foreign assets and other factors, which are considered together in order to eliminate valuation effects with no impact on liquidity, also had a liquidity-absorbing effect: they declined by around €4.5 billion on balance in the period under review. Liquidity needs stemming from the minimum reserve requirements dropped by €1.3 billion in net terms during the three maintenance periods, and were therefore more than enough to offset the higher liquidity needs resulting from autonomous factors.

In the period under review, maturities lowered balance sheet holdings under the Securities Markets Programme (SMP) by €7.3 billion to €188.2 billion – including revaluations. As part of the customary weekly liquidity-absorbing fine-tuning operations, the liquidity provided under the SMP was absorbed in each case, neutralising the liquidity-providing effect of the programme. The weighted allotment rate for the SMP liquidity-absorbing tenders rose on average to 0.10% in the period under review (compared with an average of 0.07% in the three previous maintenance periods). This allotment rate had stood at 0.01% for almost all of January 2013. Maturities and revaluations also reduced balance sheet securities holdings under the Covered Bond Purchase Programmes (CBPP1 and CBPP2) over the same period. However, the declines here were considerably lower, namely by €2.0 billion to €42.8 billion (CBPP1) and by €0.4 billion to €15.5 billion (CBPP2).

Factors determining bank liquidity[1]

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

Item	2013		
	10 July to 6 Aug	7 Aug to 10 Sep	11 Sep to 8 Oct
I Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors			
1 Banknotes in circulation (increase: –)	– 8.3	– 2.8	+ 2.1
2 Government deposits with the Eurosystem (increase: –)	– 4.6	+ 24.5	– 7.5
3 Net foreign assets[2]	– 83.6	– 0.5	+ 6.4
4 Other factors[2]	+ 86.9	– 6.5	– 7.2
Total	– 9.6	+ 14.7	– 6.2
II Monetary policy operations of the Eurosystem			
1 Open market operations			
(a) Main refinancing operations	– 4.3	– 7.0	– 1.3
(b) Longer-term refinancing operations	– 9.4	– 6.3	– 17.7
(c) Other operations	– 1.9	– 0.1	– 1.0
2 Standing facilities			
(a) Marginal lending facility	– 1.1	+ 0.2	– 0.2
(b) Deposit facility (increase: –)	+ 9.5	+ 3.4	+ 20.3
Total	– 7.2	– 9.8	+ 0.1
III Change in credit institutions' current accounts (I + II)	– 16.9	+ 4.9	– 6.1
IV Change in the minimum reserve requirement (increase: –)	+ 0.6	– 0.5	+ 1.2

1 For longer-term trends and the Deutsche Bundesbank's contribution, see pp 14• and 15• of the Statistical Section of this Monthly Report. **2** Including end-of-quarter liquidity-neutral valuation adjustments.
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In the July-August 2013 maintenance period, the outstanding tender volume (excluding liquidity-absorbing fine-tuning operations) amounted to €803 billion on average (previous period: €817 billion). Of this total volume, the greater part (€677 billion, 84%) was again accounted for by the two three-year tenders, while only 13% (roughly €104 billion) came from the main refinancing operation. Although repayments of liquidity provided in the three-year tenders were made in this maintenance period, too, they were not particularly high, totalling €7.2 billion. In addition to the decrease in tender volume, an increase in autonomous factors to €511 billion on average (previous period: €501 billion) led to a decline in excess liquidity compared with the previous period by around €26 billion to €248 billion. In this maintenance period as well, a kind of frontloading was initially observed, ie current account holdings showed above-average levels at the start of the period. Following a temporary decline, however, they rose again towards the end of the period. The overnight rate remained oriented to the interest rate on the deposit facility, although the rates were somewhat higher on average over this period than in the previous one. Thus, EONIA averaged 0.095% (previous period: 0.088%) and the secured overnight rate on Eurex Repo's GC Pooling (ECB basket) averaged 0.077% (previous period: 0.066%). At €22.0 billion, average EONIA turnover was still low (previous period: €22.9 billion), while GC Pooling overnight turnover (ECB basket) came to €10.1 billion on average (previous period: €11.1 billion).

Demand in the main refinancing operations receded to €97 billion on average in the August-September 2013 maintenance period. Overall, the outstanding volume from liquidity-providing tender operations fell to €790 billion. However, because the need for liquidity resulting from autonomous factors dropped by around €15 billion compared with the previous period to €496 billion on average, excess liquidity remained virtually unchanged, averaging €249 billion. Overnight rates were down again slightly in this maintenance period, and fell as an

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
10.07.2013	MRO (FRT)	7	102.1	76.1	0.50	100.00	–	1.00	70
10.07.2013	S-LTRO (FRT)	28	3.5	–	0.50	100.00	–	1.00	21
10.07.2013	FTO (–)	7	– 195.5	–	0.13	33.12	0.09	1.28	105
17.07.2013	MRO (FRT)	7	104.4	74.4	0.50	100.00	–	1.00	73
17.07.2013	FTO (–)	7	– 195.5	–	0.12	70.53	0.10	1.22	102
24.07.2013	MRO (FRT)	7	102.3	29.3	0.50	100.00	–	1.00	76
24.07.2013	FTO (–)	7	– 195.5	–	0.14	25.32	0.11	1.18	106
31.07.2013	MRO (FRT)	7	109.2	29.2	0.50	100.00	–	1.00	78
31.07.2013	FTO (–)	7	– 195.5	–	0.20	34.75	0.13	1.18	112
01.08.2013	LTRO (FRT)	91	2.7	–	[4] 0.53	100.00	–	1.00	43
07.08.2013	MRO (FRT)	7	99.4	89.9	0.50	100.00	–	1.00	73
07.08.2013	S-LTRO (FRT)	35	3.9	–	0.50	100.00	–	1.00	24
07.08.2013	FTO (–)	7	– 192.5	–	0.13	43.42	0.11	1.40	123
14.08.2013	MRO (FRT)	7	97.6	128.1	0.50	100.00	–	1.00	71
14.08.2013	FTO (–)	7	– 192.5	–	0.12	24.44	0.10	1.35	126
21.08.2013	MRO (FRT)	7	97.7	126.7	0.50	100.00	–	1.00	64
21.08.2013	FTO (–)	7	– 192.5	–	0.11	35.11	0.10	1.48	123
28.08.2013	MRO (FRT)	7	97.1	107.1	0.50	100.00	–	1.00	63
28.08.2013	FTO (–)	7	– 190.5	–	0.13	64.47	0.11	1.51	123
29.08.2013	LTRO (FRT)	91	6.8	–	[4] …	100.00	–	1.00	38
04.09.2013	MRO (FRT)	7	95.6	117.1	0.50	100.00	–	1.00	66
04.09.2013	FTO (–)	7	– 190.5	–	0.10	79.93	0.09	1.65	133
11.09.2013	MRO (FRT)	7	97.2	69.7	0.50	100.00	–	1.00	70
11.09.2013	S-LTRO (FRT)	28	3.4	–	0.50	100.00	–	1.00	23
11.09.2013	FTO (–)	7	– 190.5	–	0.09	92.29	0.08	1.56	128
18.09.2013	MRO (FRT)	7	96.2	72.7	0.50	100.00	–	1.00	79
18.09.2013	FTO (–)	7	– 190.5	–	0.09	9.30	0.08	1.43	122
25.09.2013	MRO (FRT)	7	97.0	54.5	0.50	100.00	–	1.00	74
25.09.2013	FTO (–)	7	– 190.5	–	0.19	46.13	0.11	1.30	116
26.09.2013	LTRO (FRT)	84	8.6	–	[4] …	100.00	–	1.00	51
02.10.2013	MRO (FRT)	7	94.5	83.5	0.50	100.00	–	1.00	73
02.10.2013	FTO (–)	7	– 187.5	–	0.09	79.35	0.08	1.41	117

* For more information on the Eurosystem's operations from 10 April 2013 to 9 July 2013, see Deutsche Bundesbank, Monthly Report, August 2013, p 35. **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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average over the period to 0.079% (EONIA) and 0.051% (Overnight GC Pooling, ECB basket) respectively. The underlying turnover also contracted to total €19.1 billion (EONIA) and €9.6 billion (GC Pooling, ECB basket), however.

The outstanding volume from tender operations (excluding liquidity-absorbing fine-tuning operations) diminished further in the September-October 2013 maintenance period to €771 billion on average. This decline was due in particular to the early repayments of liquidity provided in the three-year tenders (totalling €20.1 billion, compared with €8.5 billion in the previous period). In addition, a renewed increase in autonomous factors (to an average of €502 billion) contributed to excess liquidity falling to €224 billion. The end of the quarter (end-September) saw considerably higher overnight rates and reduced turnover on that day. EONIA rose to 0.18% (+9 basis points against the previous day) and the GC Pooling weighted overnight rate (ECB basket) to 0.16% (+9 basis points). At 0.083% on average over the period, EONIA was virtually unchanged, and EONIA turnover remained low despite advancing to €23.3 billion. The same was true of the secured overnight turnover with GC Pooling (ECB basket), which totalled only €7.6 billion on average, while the corresponding rate rose to 0 066% as an average.

or comparable assistance by a Eurosystem NCB to a solvent financial institution that is facing temporary liquidity problems. Such provision of liquidity does not form part of the Eurosystem's single monetary policy: responsibility for providing ELA and the costs and risks associated with it lie with the individual NCB. In this regard, the ECB already pointed out in 2008 that ELA was only to be provided in exceptional circumstances and in line with the prohibition of monetary financing.[1]

The prevailing legal opinion is that Article 14.4 of the Statute of the ESCB and of the ECB makes it possible for NCBs to provide such liquidity assistance as part of their national functions. Accordingly, the ECB Governing Council may veto an NCB's intention to provide ELA with a two-thirds majority if it considers that these operations interfere with the objectives and tasks of the Eurosystem, which include, above all, the objective of ensuring price stability and the implementation of monetary policy. To enable the ECB Governing Council to make a proper assessment, it must be given all the relevant information on the ELA operations at an early stage. A procedure to this end has been in place since 1999, and the key features of the current procedure were summarised in the document published by the ECB in October. Besides a list of all the information that is to be given to the ECB Governing Council, this document states the deadlines to be met and the thresholds above which NCBs are required to make information available and the ECB Governing Council is obliged to examine the case.

Still no bond purchases in the form of outright monetary transactions (OMT)

The Eurosystem did not purchase any additional securities as part of monetary policy-based purchase programmes in the period under review. In particular, it still did not conduct any outright monetary transactions (OMT). The Eurosystem's holdings of securities acquired under the Securities Markets Programme (SMP), which was discontinued in 2012, amounted to €184.1 billion at the beginning of November; the two covered bond purchase programmes, which had likewise been discontinued, accounted for holdings totalling €57.4 billion.

Downward trend in both refinancing volume and excess liquidity continues

Recourse by euro-area banks to monetary policy refinancing operations was still clearly on the decline. As in the previous review periods, the key factor behind this reduction was the early repayments in the two outstanding three-year longer-term refinancing operations (LTROs). The counterparties to these two operations voluntarily repaid €69.7 billion to the Eurosystem from the beginning of July onwards. After decreasing initially in July and August, repayments started increasing again markedly in September, which points to a further reduction in market fragmentation and funding uncertainty as well as a general improvement in the economic outlook for the euro area and greater confidence among financial market participants. The volume of liquidity outstanding from the two three-year LTROs currently still stands at €615 billion of an original €1,019 billion.

Excess liquidity dropped to €193 billion on average over the reserve maintenance period that ended on 12 November 2013. As part of an analysis based on historical data, the ECB identified a range for excess liquidity of between €100 billion and €200 billion within which very short-term money market rates would begin to be geared more strongly towards the main refinancing rate again – instead of being oriented towards the deposit rate, as is currently still the case.[2] However, this estimate is inherently subject to uncertainty. For example, the link between the amount of excess liquidity and the position of short-term money market rates within the interest rate corridor is likely to depend, among other things, on the degree of segmentation in the money markets: if segmentation in the money markets decreases, excess liquidity may even fall below the ECB's estimated values without

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1 See European Central Bank, Monthly Bulletin, 10th Anniversary of the ECB, p 124.
2 See European Central Bank, Monthly Bulletin, February 2013, pp 30-35.

causing a marked increase in money market rates.

Money market rates show no strong reaction to reduction in excess liquidity and policy rate decision

Despite the above-mentioned decline in excess liquidity, the short-term euro-area money market rates have not, in fact, yet increased significantly in response. In the third quarter, there was no clear trend in the unsecured interbank overnight rate EONIA. From mid-October, the EONIA increased slightly but this upward movement was reversed again once the current estimate for HICP inflation and, above all, the ECB's policy rate decision were published.

Policy rate decision will probably be reflected in only marginally declining short-term money market rates

Money market forward rates[3] in the euro area increased again initially in July and August following a temporary decrease after the ECB Governing Council announced its forward guidance at the beginning of July, but declined again overall from September amid fewer fluctuations. This development of forward rates was also influenced by changing expectations about the future money market and liquidity conditions in the euro area and other currency areas. Moreover, decreasing segmentation in the money markets and stable money market risk indicators are likely to have contributed to this development. Following publication of the current estimate for HICP inflation, money market forward rates for 2014 fell considerably, which can be attributed to expectations of a decrease in the policy rate at the end of the year. The interest rate cut decided at the beginning of November, which came earlier than market participants had expected, resulted in an additional decline in forward rates and led to a distinct flattening of the forward curve. Based on the money market forward rates for the coming weeks, it can be assumed that the lowering of the main refinancing rate – as was already the case in May 2013 – will be reflected, at most, in a rather marginal decline in short-term money market rates. Amid still high levels of excess liquidity, the latter are oriented towards the deposit facility rate, which was not changed as part of the ECB Governing Council's latest interest rate decisions.

Monetary developments in the euro area

Macroeconomic setting

As in the previous quarters, monetary developments in the third quarter of 2013 were characterised mainly by weak lending, inflows from abroad and the interest rate constellation. For instance, sight deposits recorded a further significant expansion owing to the low opportunity cost of holding liquid funds and the relatively low interest rate on longer-term types of deposit. Once again, inflows from abroad, too, had a growth-inducing effect on the monetary aggregates. As before, the negative influences from the lending side were, above all, the result of sluggish aggregate economic growth and the balance sheet adjustment processes in the peripheral countries of the euro area. Meanwhile, there were signs of a slight recovery in economic activity, and the decline in loans to the private sector for the euro area as a whole was somewhat slower than in the previous quarter.

Monetary developments subdued

Against this backdrop, the third quarter of 2013, too, was characterised by a moderate expansion of M3 alongside a decline in lending. M3 growth was driven mainly by a renewed substantial build-up of sight deposits, which was stimulated by a further decline in interest rates for other deposits. Given that the non-overnight deposits included in M3 and the marketable instruments went down on balance, M3 growth was once again only moderate. The annual growth rate fell slightly to 2.1%, continuing the downward trend observed since the beginning of the year.

Lending to the private sector still declining

At the same time, the annual growth rate for lending to the private sector (adjusted for loan sales and securitisation) slid even deeper into negative territory and stood at -1.4% at the end of the third quarter of 2013. This meant that, although the annual rates of monetary

3 Implied forward rates (derived from swap rates) for the unsecured interbank overnight rate EONIA, and interest rates on exchange-traded three-month Euribor futures.

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

Changes in € billion, seasonally adjusted

Assets	2013 Q3	2013 Q2	Liabilities	2013 Q3	2013 Q2
Credit to private non-MFIs in the euro area	– 60.5	– 91.4	Central government deposits	– 29.3	9.8
Loans[1]	– 50.5	– 99.6	Monetary aggregate M3	43.9	19.0
Securities	– 4.0	16.1	*of which:* Components		
Credit to general government in the euro area	– 26.8	25.5	Currency in circulation and overnight deposits (M1)	81.6	67.0
Loans	– 8.6	– 35.6	Other shorter-term bank deposits (M2-M1)	– 20.7	– 10.7
Securities	– 18.2	61.1	Marketable instruments (M3-M2)	– 17.0	– 37.2
Net external assets	50.5	82.6	Monetary capital	– 50.7	– 31.5
Other counterparts of M3	– 5.3	– 27.2	*of which*		
			Capital and reserves	10.2	36.2
			Other longer-term financial liabilities	– 60.8	– 67.6

***** Adjusted for statistical changes. **1** Adjusted for loan sales and securitisation.
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and credit growth were moving in the same direction, the gap between them remained large.

Loan growth in the euro area still mixed

The significant decline in loans to the euro-area private sector was, above all, a reflection of a still weak economic situation and the persistently great need for deleveraging in the peripheral countries of the euro area. Spain in particular recorded another strong reduction in lending to the private sector, although loans were down in the other peripheral countries, too. Yet the banks from the four large euro-area member states recorded a net slowdown in outflows or even an expansion in lending business with the non-financial private sector compared with the previous quarter, which may be partly attributable to the gradual recovery in economic activity that began in spring.

Significant net redemptions among non-financial corporations

Lending business with the non-financial private sector continued to feature a two-pronged development. The perceptible increase in loans to households in the third quarter was met with another considerable decline in loans to non-financial corporations, which could be observed in the peripheral countries in particular, but to a lesser extent also in Germany. To some extent, this was due to the fact that non-financial corporations in a number of euro-area countries partly replaced loans with market financing or by making greater use of internal funding. Furthermore, it should be noted that the change in loans to non-financial corporations typically lags behind both macroeconomic developments and investment by around three quarters.

According to BLS, marginal tightening of standards and slight decline in demand

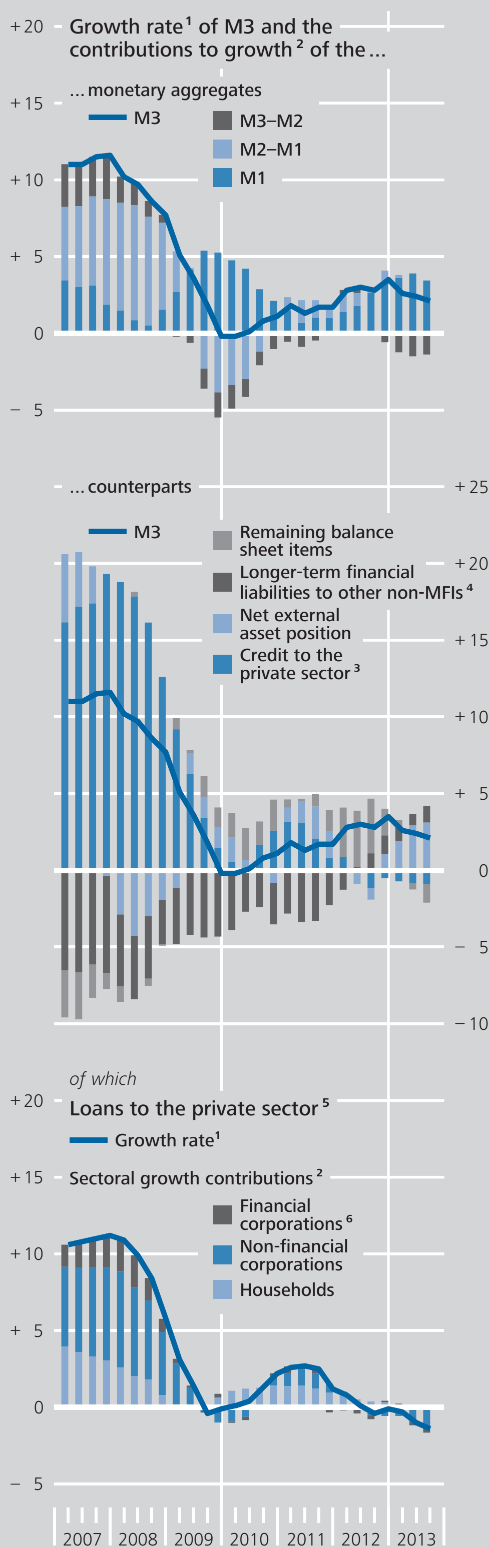
This is consistent with the fact that euro-area banks participating in the third-quarter Bank Lending Survey (BLS) reported a moderate decline in demand from non-financial corporations for bank loans. According to the surveyed bank managers, it was the deterioration in the perception of risk that prompted banks to once again slightly tighten the standards for loans to enterprises. However, in the vast majority of countries there was no adjustment of standards whatsoever in the third quarter and banks in almost all the remaining countries tightened them only moderately.

Perceptible increase in lending to households

The standards for loans to households, too, remained almost unchanged according to the surveyed banks. Moreover, for the first time since 2010, they reported no further decline in households' funding requirements. In line with these survey results, there was a perceptible overall rise (adjusted for loan sales and securitisation) in loans to households for the euro area, although the increase was again confined to the euro area's core countries. The expan-

Monetary aggregates and counterparts in the euro area

Seasonally adjusted, end-of-quarter data



Source: ECB. **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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sion was supported above all by the positive development in housing loans in France and Germany. By contrast, against the backdrop of the current need for household deleveraging, loans for house purchase continued to decline in some of the euro area's peripheral countries and in the Netherlands. Consumer credit and other lending saw slight net redemptions for the euro area as a whole and also for most of its member states, while in Germany consumer credit expanded.

No further increase in credit to general government

As with credit to the private sector, credit to general government, too, dampened the expansion of the monetary aggregate M3 this time. This was due on the one hand to net redemptions of loans to general government and on the other to net sales of government bonds by monetary financial institutions (MFIs) in France in particular but also in other member states. This development was discernible even in Italy and Spain, where demand had still centred on securities of their domestic public sectors in the previous quarters.

Another distinct rise in the net external asset position

As in the previous quarters, the banking sector's net external asset position contributed substantially to monetary growth. As before, the inflows were driven above all by sustained current account surpluses. Unlike in the preceding quarters, however, there were hardly any expansionary influences from securities transactions with non-residents. Although non-residents continued to purchase resident-issued shares, there were perceptible capital outflows due to purchases of non-resident securities by resident investors. In addition, trade in debt securities issued by domestic non-MFIs again resulted in marked capital exports. This somewhat curbed the net capital inflows in European non-banks' portfolio investment that had begun in mid-2012.

Accelerated decline in monetary capital

Monetary growth was also supported by the sustained decline in monetary capital, which accelerated once again compared with the previous quarter. Besides the continuing outflows from long-term time and savings deposits, this

Changes in bank holdings of domestic government bonds in the euro area

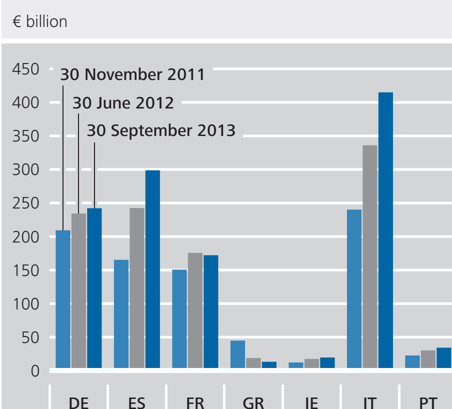
In many euro-area member states, balance sheet adjustments and the ongoing process of deleveraging are the defining features of the current situation in the banking sector. With reference to balance sheet data aggregated at national level, this has meant both shifts in banks' funding structures and changes on the asset side. Whilst, for instance, claims on non-residents and loans to the non-financial private sector in the euro area have shrunk, banks' holdings of domestic government bonds have expanded in most euro-area countries.

A large part of the additional purchases of government debt securities coincided with the three-year longer-term refinancing operations (LTROs) at the end of 2011 and the beginning of 2012.[1] However, banks in Spain and Italy in particular continued to buy government bonds on an ongoing basis thereafter. As a result, the domestic government bonds held by Italian banks rose from €240 billion at the end of November 2011 to €415 billion at the end of September 2013 (+73%); over the same period, Spanish banks expanded their holdings of Spanish government debt securities by 81%, from €165 billion to €299 billion.[2] Irish banks (+60%) and Portuguese banks (+51%) also purchased greater volumes of domestic government bonds, whilst the increase at credit institutions based in Germany and France was considerably smaller (16% and 14% respectively). At the end of the period under review, Greek banks had significantly lower holdings than they did just under two years before, though this is largely attributable to extraordinary statistical effects and valuation effects, such as the haircut in March 2012.

These expanded holdings have resulted in a closer interdependency between banks and governments, particularly in those countries where they were already bound by relatively close ties at the beginning of the period under consideration. For instance, even before the first three-year LTRO in November 2011, domestic government bonds accounted for 6% and 4.7% of aggregate bank balance sheets in Italy and Spain respectively, levels well above the (weighted) average of 3.0% for the euro area. By September of this year, these ratios had risen to 10.1% and 9.1%. The 6.6% ratio at Portuguese banks at the current end is also sig-

Holdings of domestic government bonds in the national MFI sector*)

€ billion



Source: ECB. * Excluding ESCB.
Deutsche Bundesbank

1 See Deutsche Bundesbank, Substantial government bond purchases by Eurosystem and commercial banks, Monthly Report, May 2012, p 32.
2 Changes in holdings may also arise from valuation effects and from exceptional statistical effects, such as the reclassification of a bank as a result of a resolution process. However, the results are similar after adjusting for such effects.

nificantly higher than the (weighted) average for the euro area (4.3%).[3]

As well as the attraction of being able to use government bonds as collateral in refinancing operations and for making interest rate gains through carry trades, general risk and return considerations are also likely to have prompted banks' government bond purchases. The low risk weighting of government bonds within the context of more stringent capital requirements is likely to have played a part, too. Accordingly, in the first six months of this year banks based in Italy and Spain once again bought domestic government debt securities in large volumes, whilst at the same time Spanish banks in particular made greater use of the option to return liquidity obtained through the three-year LTROs to the Eurosystem before the due date. Furthermore, since the end of 2011 banks in Italy, Spain, Portugal, Ireland and Germany have substantially reduced their funding through the issuance of bank debt securities.

Despite falling at the current end, since the beginning of the year banks' holdings of government bonds in the countries under consideration have, overall, either risen or at least contracted to a lesser extent than their outstanding funds from the three-year LTROs. It follows from this that early repayment of these LTRO funds and net redemptions of bank debt securities have, at least in part, been replaced by other funding sources or financed through a larger reduction of other positions on the asset side of banks' balance sheets. Nationally aggregated balance sheet data indicate that this has occurred through inflows of short-term deposits and a contraction in loans to the private sector. The latter applies mainly to the southern peripheral countries of Spain, Italy and Portugal, where the reduction in loans to the private sector was equal in volume to around 90% of the reduction in refinancing through LTROs and bank debt securities. By contrast, in the euro area as a whole the reduction in these forms of refinancing was offset more equally by asset and liability items, with deposit inflows and the fall in loans each making up a little over 20%. In addition, loans to the domestic public sector contracted in all the countries under consideration, which means that part of the expansion in government bond holdings is attributable to the replacement of loans by debt securities. For instance, domestic government bonds purchased by Spanish banks since January, totalling more than €45 billion, contrast at the same time with net redemptions of loans by the Spanish state, amounting to around €15 billion – which equates to a substitution rate of 37%. For Italy and Portugal the ratio of net redemptions of loans to purchases of government debt securities was much lower at around 14%, whilst in Germany, Ireland, Greece and France both government debt securities and loans to government fell on balance from early 2013 onwards.

3 In the second quarter of 2013 Spanish credit institutions thus held 41% of the total outstanding stock of Spanish government bonds, while Portuguese and Italian banks still held 27% and 24% respectively of domestic government bonds (Ireland: 16%; Germany: 15%).

was attributable in particular to the further strong reduction in outstanding long-term bank debt securities, which have been declining almost without interruption since August 2011. In addition to the weak demand for bank debt securities – most prominent in countries with problems in their banking sectors – bank-side factors are likely to have played a role, too. In view of the continuous rise in the deposits of euro-area institutions and the possibility to obtain cheap funds from the Eurosystem (eg as part of the two three-year LTROs launched at the end of 2011 and the beginning of 2012), it is fair to assume that the waning importance of long-term bank debt securities is at least partly attributable to banks replacing them with alternative sources of funding. This is consistent with the fact that the banks questioned in the BLS reported further slight improvements in most surveyed sub-markets with regard to their funding options.

Money-based forecasts with balanced inflation risks

Overall, the analysis of the monetary aggregates and their counterparts suggests that the underlying monetary dynamics that are relevant to inflation remain subdued. On average, inflation forecasts based on various monetary indicators (monetary aggregates, short-term deposits, loans) are also currently signalling balanced risks for price developments over the next three years; perceptible downward risks to price stability are not discernible either. However, the uncertainty associated with these forecasts remains high.

German banks' deposit and lending business with domestic customers[4]

Deposit growth in low-interest-rate environment still dominated by increase in sight deposits

Investment behaviour in Germany, too, was again characterised in the summer months by a continued increase in short-term deposits and a simultaneous reduction in longer-term deposits. In connection with the historically low level of shorter-term interest rates, the marked preference for liquid investments has been reflected in a substantial increase in sight deposits for the past one and a half years now. Mainly households, but also non-financial corporations, shifted funds from short-term time deposits into overnight deposits. As in the euro area, this was partly because the interest rate spread between these two types of deposit continued to decline in the third quarter. It is likely that, in Germany, the high liquidity among non-financial corporations amplified the growth in sight deposits in the reporting quarter.

Institutional investors' risk aversion now diminished

However, unlike in the previous quarters, financial corporations, whose investment behaviour is often later imitated by the non-financial private sector, shifted a distinct volume of liquid deposits to investment forms outside of M3.

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

Changes in € billion, seasonally adjusted

Item	2013 Q2	2013 Q3
Deposits of domestic non-MFIs[1]		
Overnight	33.3	35.9
With agreed maturities		
of up to 2 years	− 7.9	− 13.7
of over 2 years	− 6.0	− 10.2
Redeemable at notice		
of up to 3 months	3.9	1.6
of over 3 months	− 3.6	− 2.2
Lending		
to domestic general government		
Loans	− 3.7	− 3.0
Securitised lending	− 4.2	7.1
to domestic enterprises and households		
Loans[2]	− 1.7	4.1
of which to households[3]	3.7	6.7
to non-financial corporations[4]	− 5.0	− 3.4
Securitised lending	6.4	1.0

* 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** Adjusted for loan sales and securitisation. **3** Including non-profit institutions serving households. **4** Corporations and quasi-corporations.

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4 Statistical Supplement 4 to the Monthly Report, Seasonally adjusted business statistics, will, from now on, provide additional tables on outstanding amounts and transaction-related changes in the lending and deposit business of MFIs (excluding the Bundesbank) in Germany with domestic customers. The range of time series available on the Bundesbank's website has been expanded accordingly.

Loans of German banks to selected sectors

Seasonally adjusted and adjusted for loan sales and securitisation, end-of-quarter data

1 Year-on-year rate of change. **2** Non-monetary financial corporations. **3** Corporations and quasi-corporations.
Deutsche Bundesbank

This may indicate that these investors' risk aversion, which resulted in strong growth in sight deposits in autumn 2008 and in the years 2011 and 2012, has now diminished. This is more evident in the long-term maturity segment, where long-term time deposits in particular, whose dynamics are mainly determined by insurance corporations and pension funds in Germany, have been dissolved to a considerable extent over the past few quarters. These funds, too, are likely to have been channelled into assets outside M3 in the search for yield.

Increased lending to households driven by loans for house purchase …

Following three weak quarters, lending business in Germany witnessed a moderate increase in summer, partly offsetting the considerable reduction in lending in the euro area as a whole. First, banks resumed their increase in lending to domestic general government in the form of securities, which had been at a standstill since the beginning of the year; second, loans to the domestic private sector were further expanded. This was essentially the result of a distinct rise in loans to households. Since the third quarter of 2010, these loans had been decisively influenced by the demand for housing loans, which was supported by the extremely low mortgage rates. Furthermore, the very low yields on financial assets and a financial market climate characterised by heightened uncertainty promoted portfolio shifts into tangible assets.[5] At an annual growth rate of 2.2%, the increase in mortgage loans granted to households nevertheless remained moderate. The third-quarter BLS results confirm that the trend of rising demand for private housing loans continued in the third quarter of 2013, albeit – as in the previous quarter – at a weaker pace. According to the surveyed bank managers, the main reason for this sustained demand was that households were continuing to take a positive view of the outlook on the housing market.

… and consumer credit

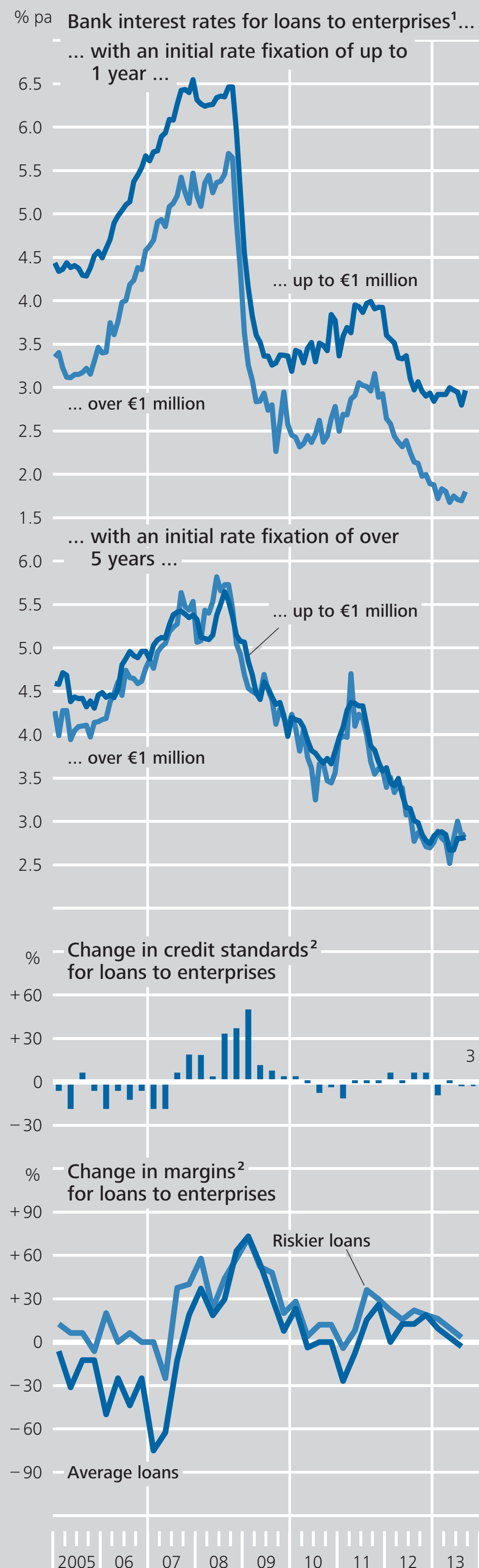
With regard to consumer credit to households in Germany, the still favourable conditions for private consumption and, above all, the underlying trend of rising purchasing power were reflected in accelerated but still moderate growth. The banks surveyed as part of the BLS likewise reported that the pick-up in demand for consumer credit had continued from the previous quarter.

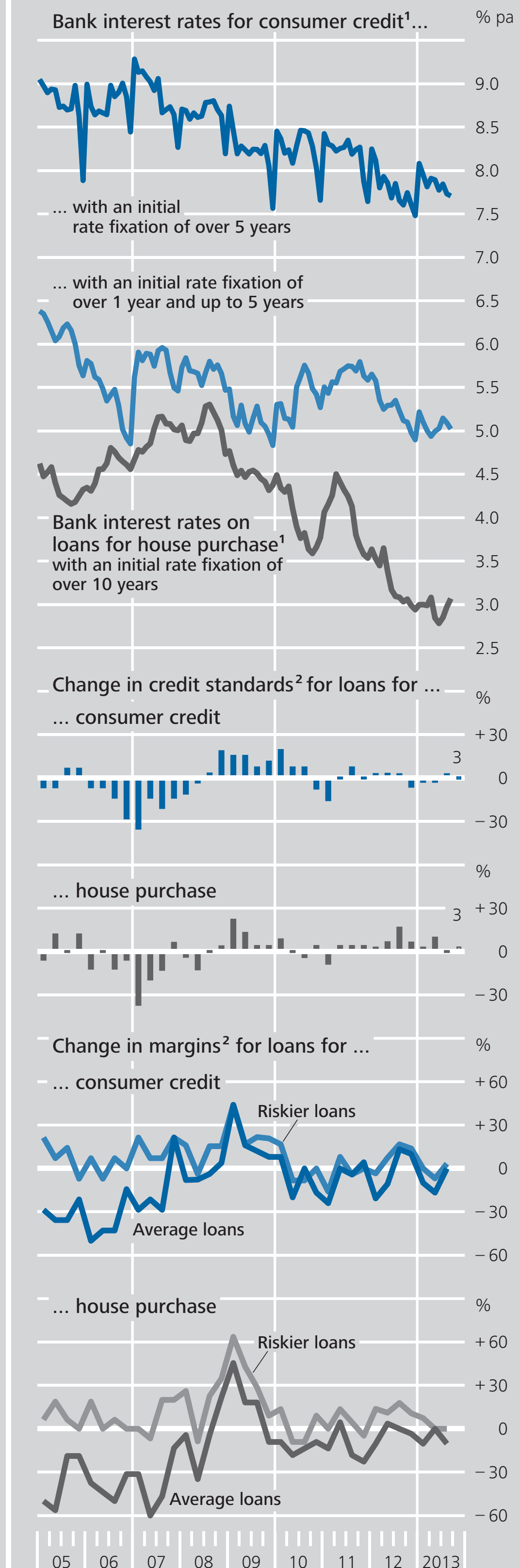
Lending to non-financial corporations sees decline

On balance, loans to non-financial corporations in the third quarter were not only down in the euro area as a whole, but also in Germany – albeit to a much lesser extent. Given that developments in loans to the corporate sector typically lag behind both macroeconomic developments and investment, the net redemptions of loans to enterprises over the last four quarters can best be explained by German enterprises' very weak investment activity in 2012. In the coming quarters, too, a marked pick-up in loan growth may be delayed by the underlying trend of still-subdued investment activity in Germany.

5 For a current analysis of house prices in Germany, see Deutsche Bundesbank, The determinants and regional dependencies of house price increases since 2010, Monthly Report, October 2013, pp 13-30.

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 slightly" and the number of respondents reporting "eased somewhat" and "eased considerably" as a percentage of the responses given. **3** Expectations for 2013 Q4.

Deutsche Bundesbank

Added to this is the fact that corporate loan demand, when viewed in isolation, is being reduced by greater recourse to alternative sources of financing. An increasing trend towards debt financing on the capital market could already be observed in the previous quarters, and this is likely to have continued over the summer months. In addition, it can be assumed that a larger proportion of corporate investments were made using internal funds, as the BLS results confirm on the whole. The participating German banks indicated that recourse to other sources of funding, internal financing in particular, had the effect of dampening enterprises' demand for bank loans, when viewed in isolation, in the reporting quarter. However, according to the bank managers surveyed in the BLS, enterprises' demand for loans remained largely unchanged in the third quarter of 2013.

German banks' credit standards for enterprises virtually unchanged

On the supply side, the moderate pick-up in domestic lending to the private sector was accompanied by merely a slight change in lending policies on the whole. According to the German BLS results, the surveyed institutions adjusted their standards for loans to enterprises only marginally on balance in the third quarter of 2013. Small and medium-sized enterprises nevertheless benefited from slightly eased standards. Thus, the period of little overall change in lending policies, which has already lasted for four years now, continued. None of the factors surveyed in the BLS that are relevant for credit standards on loans to enterprises displayed any noteworthy expansive or restrictive trends. Margins, too, were left broadly unchanged by the surveyed banks.

Almost no changes to credit standards vis-à-vis households

Credit standards vis-à-vis households, too, changed only slightly. None of the surveyed factors relevant to the standards on housing loans and consumer credit had a noteworthy impact on lending policies in the third quarter. Whereas the institutions participating in the BLS made virtually no changes to the margins for consumer credit and riskier housing loans, they adjusted their margins somewhat for housing loans to borrowers with average creditworthiness.

Viewed in isolation, sovereign debt crisis having no impact on lending policies

The survey for the third quarter of 2013 again contained *ad hoc* questions on the impact of the financial and sovereign debt crisis on banks' funding conditions and credit standards. As in the previous two quarters, the surveyed banks reported a slight improvement on the whole in funding conditions. The surveyed institutions stated that the sovereign debt crisis continued not to have any impact whatsoever on their lending policies in the third quarter.

Bank lending rates followed higher capital market interest rates

Owing to their still very low level, bank lending rates on new business probably tended to support domestic lending to the private sector. However, bank lending rates in the third quarter of 2013 followed the moderate increase in capital market interest rates to some extent after having largely stagnated or declined in the preceding quarter. With regard to loans to enterprises the interest rate rise was, however, only very slight in the third quarter. For short-term funds, the reporting institutions were charging interest of 3.0% for small-scale and 1.8% for large-scale loans at the end of the period under review. The interest rates on long-term loans to domestic non-financial corporations stood at 2.8% and 2.9% respectively at the end of September.

By contrast, housing loans of all maturities were more expensive than three months previously. Interest rates on long-term loans for house purchase went up by just under 30 basis points and stood at 3.1% at the end of September. While the remuneration of households' deposits stagnated or fell in the third quarter, reaching new historical lows in some cases, interest rates on longer-term deposits made by non-financial corporations rose somewhat.