Monetary policy and banking business

Monetary policy and money market developments

Key interest rates still at all-time low

In view of the modest economic recovery and expectations that the ongoing improvement will gradually push inflation rates higher, the ECB Governing Council has taken no further policy action so far this year. The interest rates on the marginal lending facility and main refinancing operations have thus stood at 0.75% and 0.25% respectively since mid-November 2013, while the interest rate on the deposit facility has been 0.00% since mid-July 2012.

ECB Governing Council signalling readiness to take further monetary policy measures

The ECB Governing Council has underscored its intention to keep key interest rates at their present or lower levels for an extended period of time, in the light of its assessment that high levels of unutilised capacity and the subdued monetary and credit dynamics will curb the inflation outlook over the medium term. The ongoing decline in inflationary pressure also prompted the Governing Council at the beginning of April to signal that, within the scope of its mandate, it would also resort to unconventional instruments in order to cope effectively with potential risks arising from a too prolonged period of low inflation. These risks in particular include the danger of longer-term inflation expectations, which are currently still close to 2%, adjusting downwards as the low-inflation period continues.

Still no OMT bond purchases

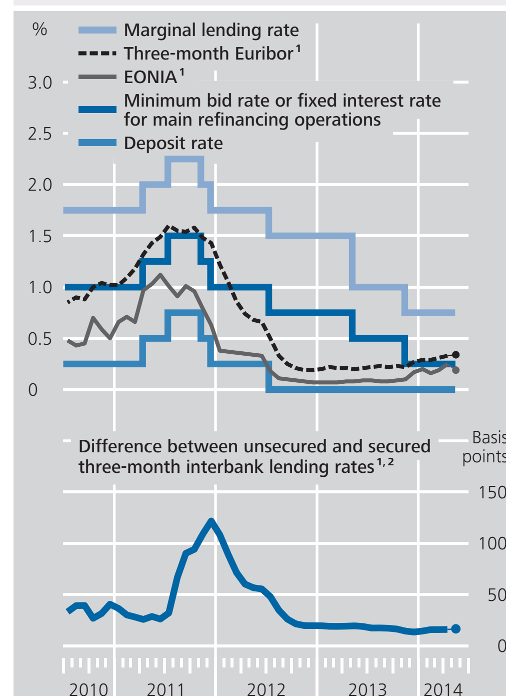
The Eurosystem did not purchase any additional securities as part of monetary policy-based purchase programmes in the period under review. In particular, there were still no outright monetary transactions (OMT). The Eurosystem's holdings of securities acquired under the Securities Market Programme (SMP), which was terminated in 2012, and the two covered bond purchase programmes (CBPP), which have likewise been discontinued, are diminishing over time as instruments reach maturity.

Overall downward trend in refinancing volume and excess liquidity …

The outstanding refinancing volume declined further in the period under review as a result of continued voluntary repayments of the funds provided in the three-year tenders. Although repayments in February were initially modest, March, in particular, saw banks pay back sizeable volumes of funds, which is likely to have been connected to balance sheet reporting at the end of the quarter and the residual maturity of the second three-year tender falling to less than a year.[1] Banks continued to make relatively large repayments in April, too, causing overall excess liquidity to drop further by the end of the month and dip below the €100 billion threshold for the first time since August 2011. This was

1 As the residual maturity has fallen to below one year, the liquidity no longer counts towards the net stable funding ratio (NSFR), which some market participants are already striving to comply with before it officially comes into force.

Money market interest rates in the euro area



Source: ECB. 1 Monthly averages. 2 Three-month Euribor less three-month Eurepo. • Average 1 to 14 May 2014.
Deutsche Bundesbank

Money market management and liquidity needs

In the three reserve maintenance periods from 15 January to 8 April 2014, liquidity needs stemming from autonomous factors declined from an average of €492 billion in the January-February period to €468 billion in the March-April period. The autonomous factors in the euro area were very volatile, ranging between €451 billion and €512 billion. While government deposits increased by €12.6 billion on balance, a reduced overall amount of banknotes in circulation (-€9.5 billion on balance) and liquidity-providing changes in the remaining autonomous factors resulted in a lower calculated need for central bank liquidity among euro-area credit institutions (see table below). In addition, this effect was enhanced by a net decline of €0.3 billion in the minimum reserve requirement.

The outstanding tender volume (excluding liquidity-absorbing fine-tuning operations) declined from €672 billion to €627 billion within the period under review, primarily reflecting demand in the main refinancing operations and early repayments of the two three-year tenders. The average volume of main refinancing operations of around €100 billion tended to increase towards the end of the month, and even hit €121 billion in the March-April period ahead of the end of the quarter. Early repayments of the liquidity provided in the three-year tenders added up to €58.3 billion in total over the three reserve periods, with the willingness of banks to repay at its highest between the middle and the end of March 2014. This could have been due, amongst others, to the end-of-quarter reporting date.

Factors determining bank liquidity[1]

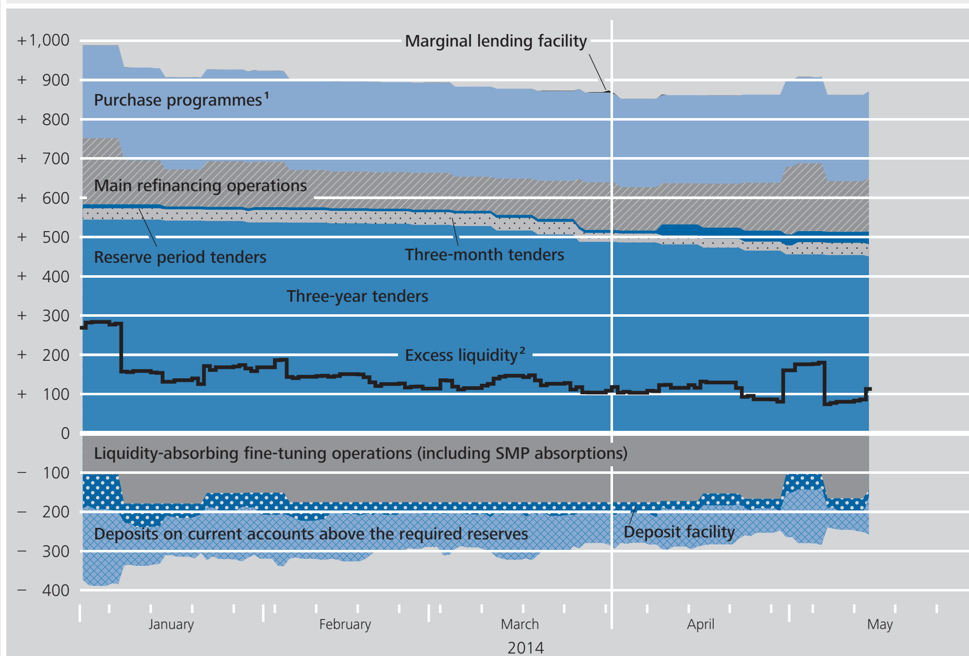
€ billion; changes in the daily averages of the reserve maintenance periods vis-à-vis the previous period

Item	2014		
	15 Jan to 11 Feb	12 Feb to 11 Mar	12 Mar to 8 Apr
I Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors			
1 Banknotes in circulation (increase: –)	+ 16.1	– 0.3	– 6.3
2 Government deposits with the Eurosystem (increase: –)	– 22.2	+ 1.6	+ 8.0
3 Net foreign assets[2]	– 22.4	+ 0.1	+ 8.5
4 Other factors[2]	+ 37.6	+ 4.7	+ 7.4
Total	+ 9.1	+ 6.1	+ 17.6
II Monetary policy operations of the Eurosystem			
1 Open market operations			
(a) Main refinancing operations	– 23.9	– 13.6	+ 13.6
(b) Longer-term refinancing operations	– 15.7	– 6.0	– 35.8
(c) Other operations	– 19.4	– 14.1	– 2.0
2 Standing facilities			
(a) Marginal lending facility	+ 0.0	+ 0.0	+ 0.4
(b) Deposit facility (increase: –)	+ 18.0	+ 12.6	+ 0.3
Total	– 41.0	– 21.1	– 23.5
III Change in credit institutions' current accounts (I + II)	– 32.1	– 14.9	– 5.9
IV Change in the minimum reserve requirement (increase: –)	– 0.4	+ 0.8	– 0.7

1 For longer-term trends and the 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.
Deutsche Bundesbank

Liquidity provision and use

€ billion, daily data



Sources: ECB and Bundesbank calculations. **1** Securities Markets Programme (SMP), First Covered Bond Purchase Programme (CBPP1), Second Covered Bond Purchase Programme (CBPP2). **2** Current account holdings minus the minimum reserve requirement plus the deposit facility.

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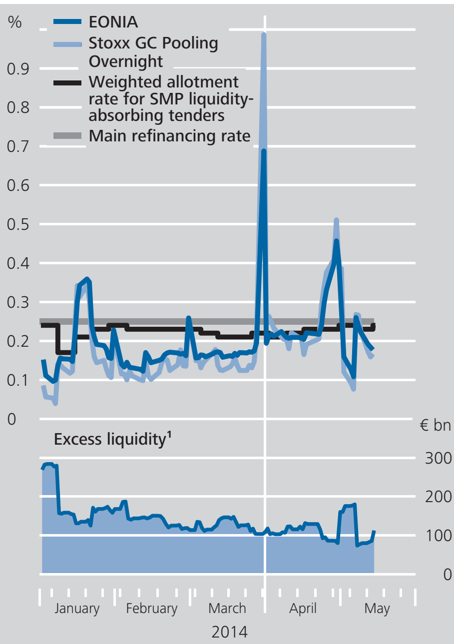
In the case of the two Covered Bond Purchase Programmes, CBPP1 and CBPP2, balance sheet holdings fell by €3.9 billion to €37.8 billion and by €0.9 billion to €14.5 billion, respectively, in the period under review. The balance sheet holdings of securities purchased as part of the Securities Markets Programme (SMP) declined by €4.9 billion to €172.5 billion owing to securities reaching maturity and quarterly revaluations. Furthermore, liquidity-absorbing fine-tuning operations were also conducted in the reporting period to neutralise the liquidity effect of securities being purchased under the SMP. Two cases of underbidding occurred towards the end of January, which further underlined the heightened preference for liquidity on the part of credit institutions before the end of the month.

From the January-February 2014 period, excess liquidity declined by an average of €34 billion to €121 billion in the March-April period, producing fairly large, short-term fluctuations which were often caused by changes in the autonomous factors, but were also the result of higher repayments of liquidity provided in the three-year tenders, more volatile demand for tenders and underbidding in the SMP liquidity-absorbing tenders (see chart above). At the end of the reporting period, excess liquidity approached the €100 billion mark.

At the beginning of the January-February maintenance period, a marked decline in excess liquidity meant that both the unsecured overnight rate EONIA and the GC Pooling rate for secured overnight money stood at distinctly elevated levels (with rates of up to 0.36%) for some days, clearly above the main refinancing rate at times (see chart overleaf). Excess liquidity increased again significantly by €46 billion to €171 billion in the following week as credit institutions adjusted their bidding behav-

Central bank interest rates, money market rates and excess liquidity

Daily data



1 Current account holdings minus the minimum reserve requirement plus the deposit facility.

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iour and overnight money market rates declined and remained relatively constant over a prolonged period of time (until the end of the quarter at the end of March), although this period was characterised by large fluctuations and a reduction in excess liquidity. Besides the regular increases at the end of the month, EONIA stood at 0.16%/0.17% for the most part, and the secured overnight rate on GC Pooling was a couple of basis points below that. The fact that overnight rates were not very volatile suggested that credit institutions had gradually become accustomed to the lower and more volatile liquidity conditions and had adapted their liquidity management accordingly. However, from the end of the quarter in March, overnight rates increased again, with rates leaping sharply at the end of March itself (up to almost 1.00%).

The allotment rates of the weekly SMP liquidity-absorbing tenders were not very volatile in the period under review and, weighted, fell just short of the maximum bid rate of 0.25%. For banks with a strong liquidity position, it was probably usually more profitable to take part in the liquidity-absorbing tenders than to lend the liquidity in the money market each day, as illustrated by the adjacent chart.

The April-May 2014 maintenance period, which followed the period under review, was characterised by volatile liquidity conditions, too, although the average EONIA was higher, at 0.24%, than in the previous period. Further repayments of the liquidity provided in the three-year tenders of an overall €32 billion and an elevated level of autonomous factors from the end of April – with increases to up to €531 billion at the end of April – caused excess liquidity to drop below the €100 billion mark on several occasions, resulting in a sharp rise in overnight rates (EONIA of up to 0.46%). In response to this and in order to safeguard liquidity at the end of the month and over the long weekend at the beginning of May, banks increased their demand substantially to €173 billion in the main refinancing operation. At the same time, there was considerable underbidding in the SMP liquidity-absorbing tender, which meant that excess liquidity suddenly rose to up to €180 billion and EONIA fell as low as 0.11%. Subsequently, liquidity conditions again changed course owing to the decline in demand in the main refinancing operations and to the virtually complete SMP-related absorption. At an average of around €80 billion in excess liquidity, overnight rates initially exceeded the main refinancing rate again and declined towards the end of the period on 13 May (GC Pooling Overnight (ECB basket) at 0.16%).

also against the backdrop of an unexpectedly high temporary increase in government deposits in the Eurosystem, which count as liquidity-absorbing autonomous factors.

… but greater weekly fluctuations of late

This reduction in excess liquidity, which was accompanied by a considerable increase in short-term money market rates, was followed by a sharp rise in banking sector demand in regular Eurosystem refinancing operations. At the same time, there was widespread underbidding in the weekly liquidity-absorbing operations.[2] Taken together, this caused the excess liquidity to more than double once again. As usual, the banking sector's demand for liquidity appeared to rise considerably owing to end-of-month effects, which were intensified by the public holiday and the bridge day. However, a change once again in the banking sector's bidding behaviour prompted a nearly complete U-turn in this trend a week later. Overall, daily excess liquidity moved within a relatively wide range (€74 billion to €179 billion) in recent weeks, a development associated with increased fluctuations in short-term money market rates.

Liquidity situation and money market rates determined by banks' individual bidding behaviour

This is due to the interaction between the liquidity situation and money market rates. When, amid falling excess liquidity, the volume of liquidity available on the interbank market runs short, say, due to a shock in autonomous factors, and banks' demand for liquidity rises, the result tends to be an increase in money market rates. As banks can only modify their individual bidding behaviour in the Eurosystem's refinancing and liquidity-absorbing operations once a week, to align it with the level of money market rates, it is possible for the EONIA to rise above the main refinancing rate for several days in a row despite full allotment in the refinancing operations. As soon as the banks adjust their bids in the Eurosystem's operations, the level of excess liquidity goes back up and money market rates fall, which is likely to prompt banks to revise their bidding behaviour once again the following week. The fact that banks do not coordinate their individual bidding behaviour with one another is likely to also trigger greater fluctuations in excess liquidity and short-term money market rates in the future. However, this should generally be seen in a positive light, as it indicates that banks are increasingly reverting to a more normal liquidity management instead of holding large precautionary reserves of excess central bank liquidity.

Marked fluctuations in money market rates in April

Short-term money market rates rose only gradually in the euro area in February and March in response to the downward trend in excess liquidity. Stronger fluctuations in the unsecured EONIA and other short-term money market rates could be observed initially only at month-end and at the end of the quarter. It was the aforementioned unexpected increase in autonomous factors, together with banks' increased preference for liquidity in the last week of April, that brought an end to the period of equilibrium following fluctuations in January, causing the EONIA to outpace the main refinancing rate for several days. Although this trend reversed itself at the beginning of May, fluctuations in short-term money market rates remained high in view of the liquidity conditions. Rising or fluctuating short-term money market rates, however, should not be seen as a sign of tensions on the money market but rather as indicating a gradual shift from a regime of high excess liquidity, in which money market rates were anchored close to the deposit facility rate, to a regime with more balanced liquidity conditions, in which money market rates should be in line with the main refinancing rate. Thus, this trend can be seen as an indication that the money market is slowly but steadily returning to normal functioning.

Money market forward rates[3] in the euro area rose slightly from the beginning to the middle

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2 Each week, the Eurosystem offers banks a liquidity-absorbing operation in the amount of the outstanding SMP portfolio volume. This operation was introduced alongside the SMP in May 2010 to underscore that the purpose of this programme was not to loosen monetary policy.
3 Implicit forward rates, derived from swap rates, for the unsecured interbank overnight rate EONIA and interest rates of exchange-traded futures on the three-month Euribor.

Very little change in money market forward rates given persistently flat forward curve

of March, after stalling at a very low level throughout almost all of February. In the remainder of the period under review up until the beginning of May, forward rates moved in a very narrow range between their low in February and their slightly higher level of mid-March. The increase and fluctuations in forward rates remained well below movements in the EONIA rate. Thus, on the whole, fluctuations in short-term money market rates have not diffused to the forward rates. Even the structure of the forward price curve remained flat throughout the months under review and is currently slightly inverted at the short end, which indicates that there is a certain likelihood that market participants are pricing in additional Eurosystem monetary policy measures or at least no longer expect interest rates to increase noticeably for the foreseeable future despite fluctuations in short-term money market rates.

Monetary developments in the euro area

Macroeconomic setting

The deleveraging process in the euro-area MFI sector, which briefly accelerated in the autumn months ahead of the ECB's balance sheet assessment, continued into the new year. In terms of balance sheet items relevant to monetary growth, this mainly concerned banks' holdings of securities issued by the private sector. Loans to the private sector are currently not the main focus of deleveraging. Lending to this sector fell only marginally over the winter months on balance. Consequently, the downward trend in monetary and credit growth which had lasted for several quarters came to a standstill in the quarter under review. Despite isolated signs that the macroeconomic recovery in recent quarters is slowly encouraging lending to non-financial corporations, it is too early to speak of a widespread recovery in loans to this sector.

M3 growth driven by overnight deposits

The M3 monetary aggregate recorded marked growth on balance in the first quarter, bolstered by continued inflows of funds from abroad. This primarily concerned overnight deposits, which benefitted from a further decline in the interest rate on other deposits and recorded considerable growth once again. By contrast, the majority of other assets contained in M3 holdings, in particular short-term time deposits, money market fund shares and bank debt securities with a maturity of less than two years, were reduced further amid low interest rates and diminishing risk aversion.

Downward trend in money and credit growth stopped

Against this backdrop, the downward trend in monetary growth since the beginning of last year came to a halt in the reporting quarter and the annual growth rate of M3 rose marginally to 1.1%. At the same time, annual growth of loans to the euro-area private sector (adjusted for loan sales and securitisation) stalled at the previous quarter's level of -2%, causing the difference between monetary growth and credit growth to remain large. Underlying monetary dynamics therefore continue to be very subdued.

Decline in loans to non-financial corporations slowed further

The volume of loans to the domestic private sector fell only slightly on balance over the winter months after a marked decrease in the previous three quarters; however, the slowdown in the downward trend was mainly powered by loans to financial enterprises, which posted net inflows for the first time in a year. By contrast, loans to non-financial corporations decreased considerably on balance, though at a slightly slower pace than in the two previous quarters. Nonetheless, the annual growth rate for these loans dropped to -3.1% as a result of a base effect.

Standards for loans to enterprises broadly unchanged according to BLS

The Bank Lending Survey (BLS), which was conducted in the first quarter, pointed to a gradual stabilisation of the non-financial corporate sector. The surveyed banks in the euro area indicated that the continued decline in non-financial corporations' demand for bank loans since the third quarter of 2011 has come to a standstill. At the same time, banks have, on balance, largely left standards for loans to enterprises unchanged at the previous quarter's

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

Changes in € billion, seasonally adjusted

Assets	2014 Q1	2013 Q4	Liabilities	2014 Q1	2013 Q4
Credit to private non-MFIs in the euro area	– 30.4	– 153.2	Central government deposits	1.8	– 25.3
Loans[1]	– 8.7	– 57.7	Monetary aggregate M3	52.6	– 10.6
Securities	– 19.0	– 89.7	*of which:* Components		
Credit to general government in the euro area	16.5	– 50.7	Currency in circulation and overnight deposits (M1)	91.3	48.7
Loans	20.2	– 14.9	Other shorter-term bank deposits (M2-M1)	– 24.0	– 39.3
Securities	– 3.7	– 35.9	Marketable instruments (M3-M2)	– 14.8	– 20.1
Net external assets	89.9	154.8	Monetary capital	6.8	– 19.9
Other counterparts of M3	– 17.5	– 12.4	*of which*		
			Capital and reserves	53.9	– 17.1
			Other longer-term financial liabilities	– 47.0	– 2.8

***** Adjusted for statistical changes. **1** Adjusted for loan sales and securitisation.
Deutsche Bundesbank

level. However, euro-area banks see this level as being relatively strict when measured against the standards that have been in place since the escalation of the sovereign debt crisis.

Heterogeneity in euro-area lending remains high

Lending to non-financial corporations continued to vary widely between euro-area countries. Of the four large member states, only French banks reported distinctly positive quarterly inflows. By contrast, lending continued to decline in Italy and, in particular, in Spain, albeit at a slower pace than in previous quarters. This could be a result of the gradual economic recovery in these countries, which – with a typical lag of several quarters – should boost lending to non-financial corporations. However, these positive stimuli are being masked by the fact that the private sector in a number of these countries still needs to take corrective action on debt reduction. Moreover, demand for credit in the euro area on the whole was also dampened as a result of non-financial corporations in some euro-area countries partially replacing bank loans by making greater use of internal financing or – in light of the favourable financing conditions for enterprises – by raising funding directly on the capital markets.

Almost all sectors in euro-area periphery countries hit by weak credit growth

An analysis of sectors shows that the corporate sector has been widely affected by weak credit growth. Not only has there been a particularly strong decline in real estate loans, which have been hit hard by the financial and economic crisis, but annual credit growth rates are visibly in negative territory in almost all other economic sectors in the euro-area periphery countries as well. Thus, a broad upward trend in lending is not yet discernible in these countries.

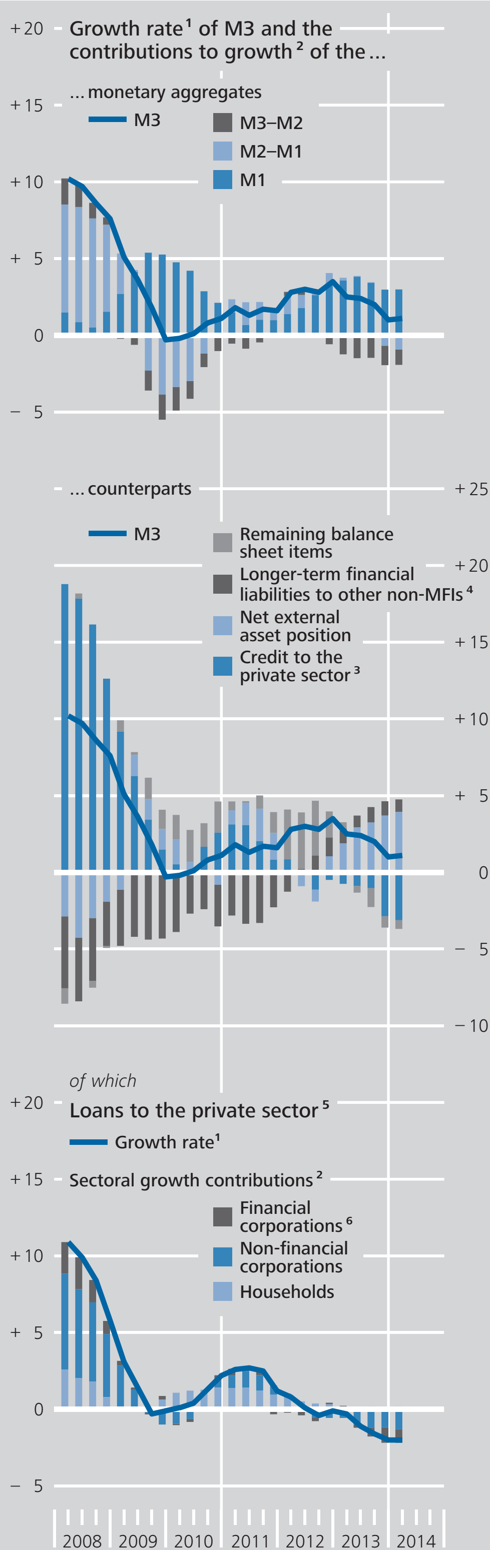
Slight increase in loans to households

Lending to households in the euro area was weak, recording an annual growth rate of only 0.4%. This was primarily attributable in the first quarter to moderate positive flows in lending for house purchase. Lending in this area, too, varies from one country to the next. Once again, growth in loans for house purchase was mainly evident in core euro-area countries. By contrast, the current need for household deleveraging in periphery countries meant that this kind of lending continued to decline.

Meanwhile, in the euro area as a whole, the ongoing economic recovery has translated into a moderate rise in private consumption, causing consumer loans on balance to go back up slightly in the first quarter for the first time in 4½ years. This overall positive growth is corroborated by the BLS. In the survey, banks signalled that they have marginally loosened credit standards for loans to households, simultaneously reporting an overall moderate increase in borrowing requirements among

Monetary aggregates and counterparts in the euro area

Seasonally adjusted, end-of-quarter data



Source: ECB. **1** Year-on-year percentage change. **2** In percentage points. **3** Adjusted for loan sales and securitisation. **4** Denoted with a negative sign because, 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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households. Thus, for the first time since the first quarter of 2007, banks reported an easing of credit standards for both housing loans and consumer loans together with a simultaneous rise in demand.

Moderate fall in securitised lending

The accelerated reduction of certain balance sheet items observed in the fourth quarter of 2013, which is likely to have been triggered by the balance sheet assessment of systemically important euro-area banks, did not continue as expected in the quarter under review.[4] In fact, non-seasonally adjusted data for the four large member states indicate that some of the transactions that were carried out in relation to the balance sheet reduction were already reversed in January. In terms of volume, these primarily concerned claims on other euro-area banks and financial derivatives in the trading portfolio, ie items that have little or no impact on monetary growth. The reduction of MFI securities holdings, too, which had picked up pace at the end of the year, slowed considerably in the first quarter of 2014. Furthermore, monthly balance sheet statistics indicate that, in January, French and Spanish banks in particular once again intensified their purchases of securities issued by euro-area governments. All in all, the reduction of securitised lending to general government and the private sector alike only had a moderate dampening effect on the expansion of the monetary aggregate M3 in the first quarter.

Marked expansion in net external asset position

The dampening effects of lending were counterbalanced by a marked expansion in the MFI sector's net external asset position. In contrast to the euro-area's continued current account surpluses, which played somewhat less of a role than in previous quarters, securities transactions with non-residents had a stronger impact on monetary growth. As in previous quarters, this was mainly driven by foreign investors' healthy demand for euro-area securities.

4 See Deutsche Bundesbank, On the decline in assets in the bank balance sheets of the four large euro-area countries, Monthly Report, February 2014, pp 37-39.

The resulting flow of capital into the euro area was only partially counterbalanced by domestic non-MFIs' purchases of foreign securities.

Monetary capital without major impact on monetary aggregate

By contrast, monetary capital had no significant impact on the monetary aggregate in the quarter under review. The overall slight increase was solely prompted by considerable growth in capital and reserves, which had declined in the fourth quarter of 2013 against the backdrop of balance sheet adjustments. Alongside small outflows from long-term bank deposits, this was primarily counterbalanced by a renewed sizeable reduction in bank debt securities with a maturity of more than two years, which had been built up again in the final quarter of 2013 for the first time since mid-2011. Despite the improvements in issuing long-term bank debt securities reported by institutions in the BLS, outflows were recorded in this area by German, Spanish and French banks in particular. This suggests that bank-related factors also continue to play a role in this context. In addition to some credit institutions requiring less funding on account of deleveraging, a key factor here is that banks have been substituting bank debt securities with alternative sources of financing, such as Eurosystem liquidity provided on favourable terms as well as continuously growing deposits. This is consistent with banks reporting an overall slight improvement in the funding situation in the BLS. According to the surveyed banks, the impact of the sovereign debt crisis on funding and credit standards has remained virtually unchanged.

German banks' deposit and lending business with domestic customers

Further increase in deposit business …

Similar to other euro-area countries, the investment behaviour of non-banks in Germany in the first quarter of 2014 was characterised by sustained growth in short-term deposits and a parallel reduction in longer-term deposits. This development reflects the money-holding sector's continued strong preference for liquidity, which in light of the even lower opportunity costs associated with holding money short-term, has prompted a marked increase in sight deposits in particular. The slight flattening of the yield curve also meant that the expansion in short-term time deposits that was already evident in the previous quarter continued to pick up pace in the quarter under review. Besides these shifts within M3, banks' deposit business in Germany in the quarter under review was once again defined by money-holding market participants moving some of their assets from relatively low-interest M3 instruments with longer maturities to riskier assets outside M3 in search of a better yield.

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

Changes in € billion, seasonally adjusted

Item	2013 Q4	2014 Q1
Deposits of domestic non-MFIs[1]		
Overnight	12.6	20.6
With agreed maturities		
of up to 2 years	1.2	9.9
of over 2 years	− 7.3	− 7.6
Redeemable at notice		
of up to 3 months	− 0.5	− 3.2
of over 3 months	− 1.3	− 0.3
Lending		
to domestic general government		
Loans	− 0.8	− 1.2
Securitised lending	5.0	− 2.0
to domestic enterprises and households		
Loans[2]	2.1	3.0
of which to households[3]	3.1	5.6
to non-financial corporations[4]	− 0.1	− 4.6
Securitised lending	− 2.6	− 1.1

* 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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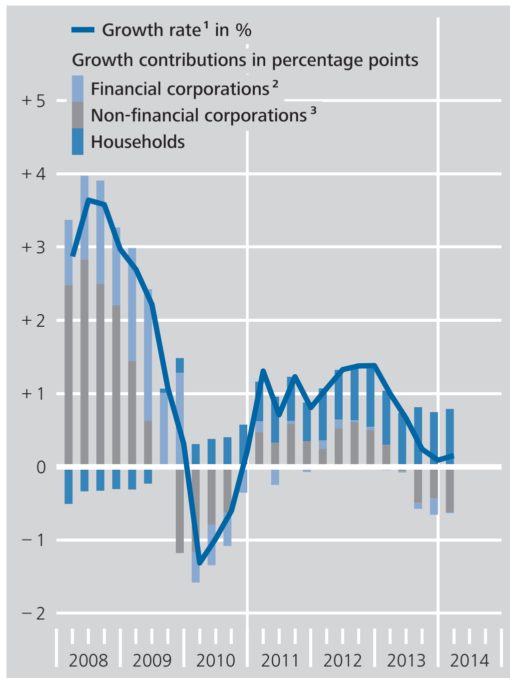
… still driven by sight deposits and short-term time deposits

In contrast to the previous quarter, growth in short-term deposits in the quarter under review was supported by all money-holding sectors, with the greatest inflows recorded from households and non-financial corporations. While households built up sight deposits once again, albeit to a noticeably smaller extent than in the

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

previous quarter, non-financial corporations were more interested in short-term time deposits, increasing their holdings noticeably in the review period after slight growth in the previous quarter. This development is likely to be the result of non-financial corporations' high level of liquidity that has been evident for several quarters and which is driven by their stable profit situation as well as a renewed narrowing in the spread between interest rates on short-term time deposits and those on M3 deposits with longer maturities.

Further decline in longer-term deposits

Moreover, domestic banks' deposit business was once again characterised by a distinct reduction in long-term time deposits in the quarter under review. As in previous quarters, the largest movements in this context were booked on the accounts of financial corporations, in particular insurance companies and pension funds. In light of the overall positive capital market developments in the quarter under review, financial corporations are likely to have shifted some of their freed-up funds to less liquid and riskier funds outside M3. Other money-holding sectors, too, reduced their longer-term M3 deposits, albeit on a much smaller scale. This was most likely due to a further decline in the remuneration of this form of investment.

Positive, yet subdued, growth in banks' lending to domestic non-banks

The revival of banks' lending business in Germany with the domestic non-bank sector, which could be observed in the preceding two quarters, did not continue at the same pace in the first quarter of 2014. This was largely attributable to a marked decrease in lending to general government and a considerable decline in loans to non-financial corporations. However, lending to the private sector developed positively overall, with loans to households recording distinct inflows and unsecuritised loans to financial corporations increasing slightly for the first time since the fourth quarter of 2012.

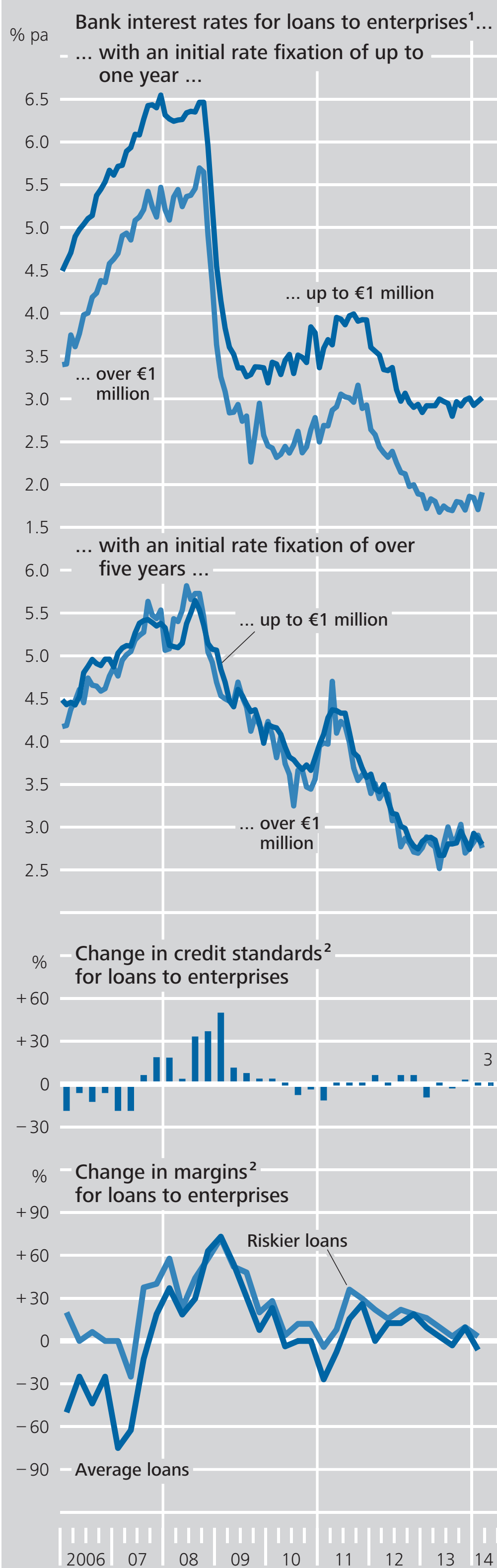
Loans for house purchase up further

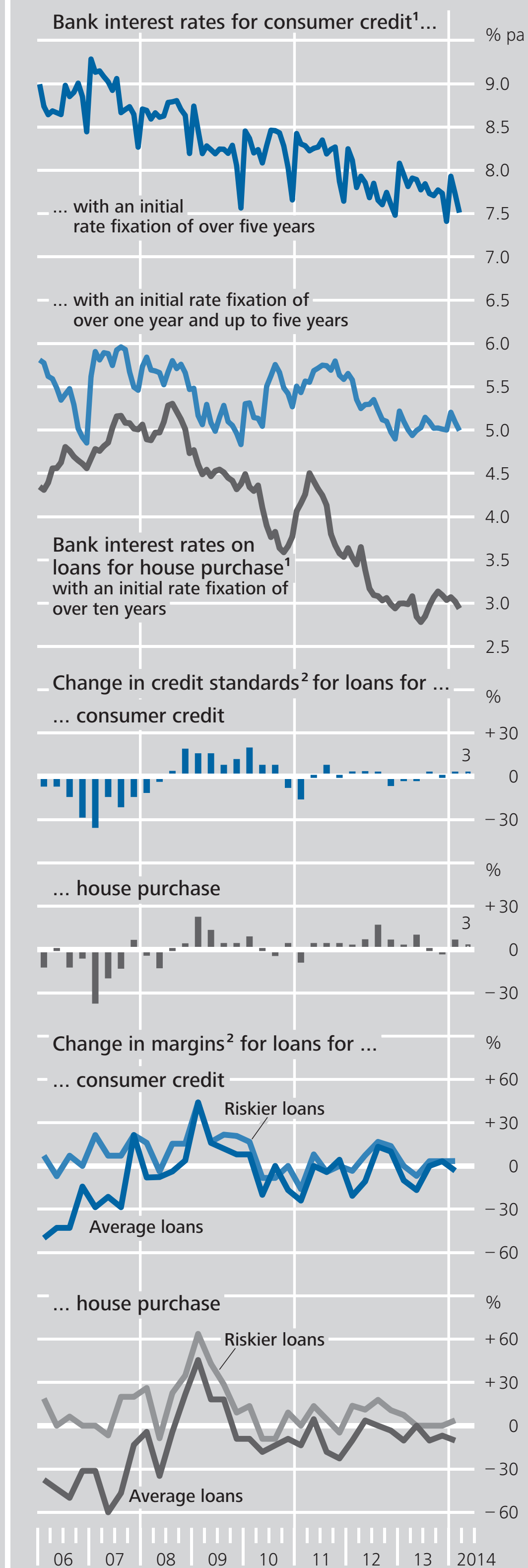
As in the previous quarters, lending to households (and thus to the entire domestic private sector) was mainly driven by loans for house purchase. These were stepped-up once again in the quarter under review, boosted to some degree by good weather and the continued favourable financing conditions. The results of the BLS also point in the same direction. Participating banks indicated a renewed upsurge in demand for loans for house purchase in the first quarter of 2014, following a gradual fall-off in demand growth in the previous quarters. According to the managers surveyed, borrowers rated the situation on the housing market in the quarter under review as being considerably better than in the previous quarter.

Expansion in consumer loans slightly accelerated

Banks participating in the BLS also saw a marked rise in demand for consumer loans in the first quarter of 2014, which was powered by improved income prospects and a greater propensity to make purchases. On balance, the favourable conditions for private consumption translated into accelerated growth in consumer lending. Nonetheless, loans to domestic households in Germany remained moderate on the

Banking conditions in Germany





1 New business. According to harmonised MFI interest rate statistics. **2** According to the Bank Lending Survey; for credit standards: 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; for margins: difference between the number of respondents reporting "widened considerably" and "widened slightly" and the number of respondents reporting "narrowed somewhat" and "narrowed considerably" as a percentage of the responses given. **3** Expectations for 2014 Q2.

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Financing environment of small and medium-sized enterprises in the euro area – concept and results of the SAFE survey

Small and medium-sized enterprises (SMEs) are often at the centre of the ongoing economic policy debate about the financing situation of firms in some countries of the euro area. Unlike large firms, SMEs have only limited possibilities to meet their financing needs by tapping the various external sources and to react flexibly to changes in the availability of certain financing instruments: the bank loan is usually the only form of external financing available to them, whereas large firms can turn to the capital market or to other non-banks.[1] Thus, any restrictions in the supply of bank loans could have a stronger impact on SMEs than on larger firms.

The European Central Bank's Survey on the Access to Finance of SMEs in the Euro Area (SAFE) provides information on the financing environment for SMEs in the euro area and facilitates an analysis at country and sector level as well as across different characteristics of the firms. The survey was introduced in 2009 after the global financial crisis escalated, at a time when many banks suffered liquidity bottlenecks and it was feared that they might significantly scale back their lending to SMEs in particular. It has been run every six months ever since and primarily examines the situation of SMEs. Large firms are included purely for comparison purposes.[2] The possible answers are of a qualitative nature only, and require the respondents to assess the situation on the basis of a set scale. A total of 7,500 enterprises are surveyed as a rule, of which just under 7,000 are SMEs.[3] The enterprises base their assessment on their financial situation and the perceived financing environment in the preceding six months. Ten survey rounds have been conducted so far; the most recent results were published on 30 April 2014.

According to the survey, the financial situation of euro-area SMEs deteriorated steadily overall during the first years of the financial and economic crisis. This was true not only of their individual earnings and profit situation but also of the attendant access to external sources of finance. By contrast, the enterprises' assessment at the current end is markedly better than before. However, there is rather a high degree of heterogeneity over the entire period, both across the euro-area countries and with regard to the different economic activities.

Most recently, SMEs in the euro area as a whole reported that their earnings situation had stabilised after it had deteriorated for a prolonged period of time in the wake of the crisis. By contrast, earnings in the construction sector, which is in particularly strong need of adjustment following the real estate boom in some countries prior to the crisis, has so far continued to worsen for the majority of respondent enterprises. The euro-area SMEs reported that the profit situation, which has been weak during the last few years in line with developments in the earnings situation, deteriorated again in

1 Of course, alternative forms of finance also exist for SMEs, such as SME bonds, promissory notes, forms of finance leasing or trade credit. However, the volume of these types of finance is relatively small.
2 SMEs are defined here as enterprises with fewer than 250 employees.
3 Given the small sample size for the majority of countries, most of which have only 500 or fewer surveyed enterprises, the survey is not entirely representative. For this reason, the results should be interpreted with caution. Larger samples of around 1,000 enterprises exist only for Germany, France, Italy and Spain.

the most recent survey round, albeit to a lesser extent than in the periods before.

Nevertheless, SMEs have recently further intensified their efforts to reduce debt, which have been observable for some time. This is especially true of SMEs in the manufacturing sector, whereas only weak deleveraging progress has been made in construction to date. At country level, the reduction of debt was found to be strongest in Ireland and the Netherlands on the whole, while SMEs in Italy saw their debt levels increase again.

Access to finance, which, according to SMEs, had deteriorated markedly in 2009 and 2012 in particular, was perceived to be less of a concern of late. The percentage of SMEs which considered that to be the most pressing problem was at its lowest level in the last survey round since the survey began (finding customers was reported as being the most pressing problem, notably at the current end). While access to finance is still considered the dominant concern for SMEs in Greece, the percentage of SMEs which held that view declined in most euro-area countries. Although the levels vary from country to country, this indicates that the financial situation is, in fact, easing. By contrast, the availability of skilled staff or experienced managers has been the main concern in Germany for quite some time.

The SAFE survey also asks specifically about the availability of bank loans in order to capture as precisely as possible any difficulties in accessing finance. In the perception of SMEs throughout the euro area, the availability of bank loans has deteriorated steadily on balance over the last few years, albeit at a much slower pace of late. The percentage of SMEs reporting a deterioration in bank loan availability dropped in the last survey round to the lowest level since the survey began. The main drivers of

The most pressing problems faced by euro-area SMEs in the second half of 2013 *

Source: ECB. * Percentage of respondents.
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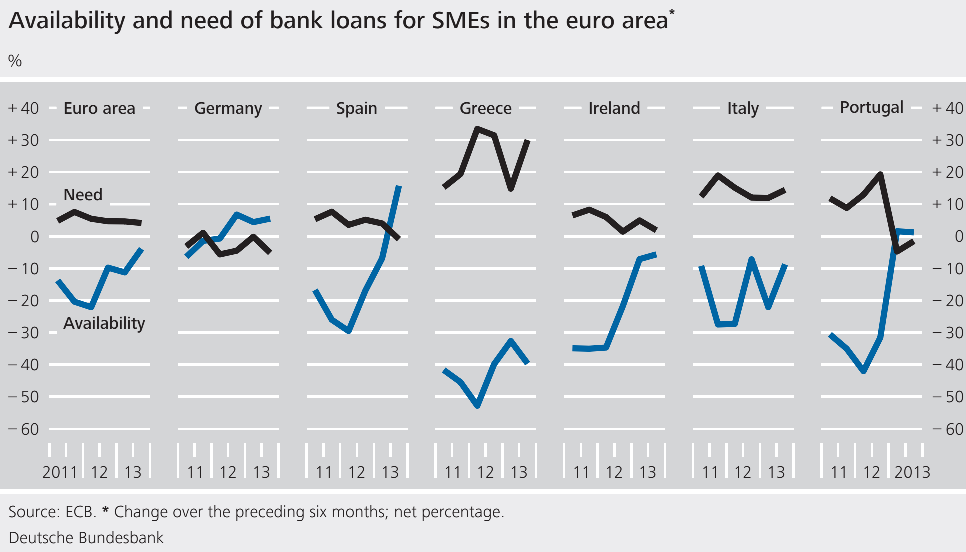
this development were the clouded macroeconomic outlook as well as firm-specific factors and factors affecting the provision of loans by banks. The worsening availability of bank loans affected the construction sector in particular. Here too, however, the deterioration was less pronounced in the last round of the survey than in previous rounds. At country level, a net improvement was again reported in Germany and Portugal, with Spain also signalling improved access to finance for the first time.

At euro-area level, the respondent enterprises have reported a constant increase in their need for bank loans over the past few years; however, the increase was only minimal in the most recent round of the SAFE survey. Whereas Greece, Italy and France signalled an especially strong rise in their need for bank loans, Germany, Portugal as well as, for the first time, Spain reported

Availability and need of bank loans for SMEs in the euro area*



Source: ECB. * Change over the preceding six months; net percentage.
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that their need for bank loans was decreasing on balance.

The SAFE survey reveals that, on the whole, euro-area SMEs expect the future to bring a slight improvement in access to finance as well as a further improvement in the availability of internal funds. The outlook was found to be particularly positive for SMEs in Germany and Spain, while for Italy it was less negative than in previous survey rounds.

whole in the first quarter of 2014 despite growth in lending: the 12-month rate for loans to households only inched upwards from 1.2% in the previous quarter to 1.3%.

Marked decline in loans to non-financial corporations

By contrast, there was a perceptible decline in banks' lending business with domestic non-financial corporations in the quarter under review, following a period of equilibrium between new lending and redemptions in the previous quarter. The rise in net redemptions of loans to enterprises in Germany is likely to be due to a number of factors. Against the backdrop of moderate investment activity and German enterprises' stable profit situation as well as the faded appeal of M3 instruments, this development suggests that enterprises have increasingly been using their earnings to pay down outstanding liabilities. Furthermore, the importance of MFI loans as a source of corporate financing has been experiencing a trend decline for years and an increasing proportion of corporate investment continues to be sourced from other forms of financing as well as through alternative lenders (especially intra-group loans, capital-market-based inflows of funds and trade credit).[5] This assessment is corroborated by the results of the BLS. The surveyed German banks have been signalling for some quarters now that it is predominantly recourse to other sources of funding, internal funds in particular, that has had a dampening effect on enterprises' demand for bank loans.

German banks' credit standards virtually unchanged for loans to enterprises …

The slight expansion observed in loans to the non-financial private sector in the quarter under review was accompanied by largely unchanged bank lending policies. The German results of the BLS indicate that on balance, in the first quarter of 2014, the surveyed institutions did not adjust their standards for loans to enterprises, irrespective of the maturity and the

5 See Deutsche Bundesbank, The structure of corporate financing amid weak loan growth in Germany and the euro area, Monthly Report, August 2013, pp 42-43.

firm size. This represents a continuation of the period of little overall change in lending policies, which commenced in mid-2009. Although equity costs as well as industry and firm-specific factors – taken in isolation – had a slight tightening effect on credit standards in the first quarter, lending from other banks, by itself, effected an easing of the surveyed banks' credit standards. Margins were adapted depending on the borrower's credit rating: on the quarter, they were narrowed slightly for average-risk loans to enterprises and widened marginally for riskier loans.

… and to households

Credit standards for loans to households also remained virtually unchanged overall. On balance, surveyed banks tightened credit standards somewhat for loans for house purchase as, in contrast to borrowers, they were less optimistic about the outlook for the housing market. At the same time, participating institutions in this line of business moderately narrowed their margins for average-risk loans. By contrast, banks active in consumer lending to households made no noteworthy adjustments to their lending policies.

Current standards for loans to enterprises relatively tight

The BLS survey conducted in April contained additional questions on participating banks' funding conditions, on the impact of the sovereign debt crisis on financing and on lending policies as well as, for the first time, questions regarding the level of credit standards. In general, the institutions reported a slight overall improvement in their funding environment in the first quarter of 2014. As in the previous quarters, the sovereign debt crisis had only a marginal impact on changes in funding conditions, but this did not affect credit standards.

The question regarding the level of credit standards in each bank's assessment referred to the midpoint of the range of credit standards since the escalation of the sovereign debt crisis. Compared with this (subjective) benchmark, the surveyed banks deem credit standards in corporate banking to be relatively tight at present. In lending to households, by contrast, they reported that, on balance, their current standards for loans for house purchase and consumer credit were only marginally tighter than the respective benchmark.

Bank lending rates tracking decline in capital market rates or stagnating

In light of their still very low level, bank lending rates on new business probably tended to support domestic lending to the private sector. In the first quarter, bank lending rates across all business areas, maturities and volumes largely tracked the slight decline in capital market rates or stagnated.

Interest rates for loans to enterprises in the first quarter remained roughly on par with the previous quarter. On average, at the end of March, the reporting institutions were charging interest of 3.0% for small-scale and 1.9% for large-scale short-term loans to domestic non-financial corporations. Interest rates for both small and large-scale long-term loans ended the reporting period at 2.8%.

By contrast, loans for house purchase in the first quarter of 2014 were somewhat more favourable. At the end of March, interest rates on long-term loans stood at 2.9%. The only exception to the general trend was the considerable increase in interest rates for short-term consumer loans. This increase shows *inter alia* that the reduction of interest rates on consumer credit typical for the last quarter of the year was reversed in the first quarter of 2014. Households' and non-financial corporations' deposits earned somewhat less interest overall compared with the previous quarter.