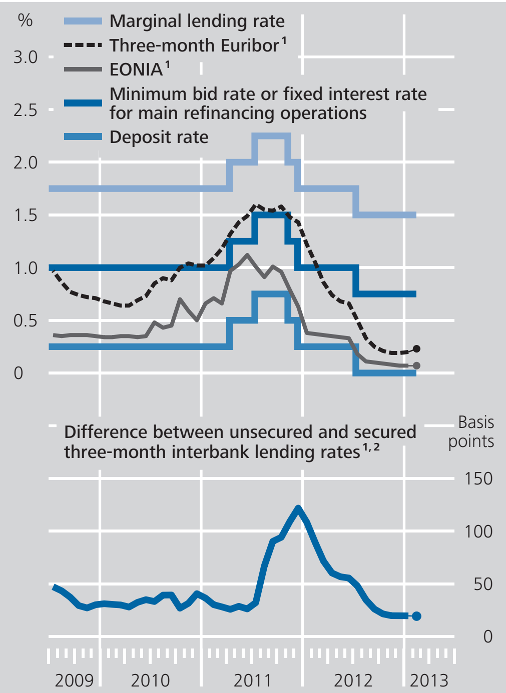
Monetary policy and banking business

Monetary policy and money market developments

Key interest rates remain unchanged at record low

Although the Eurosystem was again faced with having to considerably revise downwards it growth forecasts for 2013 and 2014 in the autumn quarter, this hardly affected the longer-term outlook on inflation. The Governing Council of the ECB remains confident that the inflation rate will decline to values below 2% in the current year and stay at a level compatible with stability over the policy-relevant horizon. No further interest rate policy measures were therefore taken by the ECB Governing Council since the interest rate was lowered at the start of July 2012. This means that the main refinancing rate remains unchanged at the record low of 0.75% set in July. Banks' balances in the deposit facility – as well as their excess reserves on current accounts – continue to earn 0% interest. Eurosystem counterparties can obtain overnight credit at 1.5% through the marginal lending facility.

Money market interest rates in the euro area



1 Monthly averages. **2** Three-month Euribor less three-month Eurepo. • Average 1 to 13 February 2013.
Deutsche Bundesbank

ECB Governing Council decides to again extend full allotment for refinancing operations

At the beginning of December 2012, the Governing Council of the ECB decided to continue to conduct its regular monetary policy refinancing operations as fixed-rate tenders with full allotment until at least mid-2013. Full allotment was first introduced with effect from 15 October 2008 – at the height of the financial crisis – as a temporary non-standard monetary policy measure. In spring 2010, the Governing Council initiated the discontinuation of the full allotment policy for refinancing operations, but shelved this goal again when the crisis intensified in May 2010. In addition, following the suspension of July 2012, the ECB Governing Council agreed, until further notice, to restore the eligibility of debt instruments issued or fully guaranteed by the Hellenic Republic for use as collateral in Eurosystem monetary policy operations with effect from 21 December 2012. They are, however, subject to special haircuts.

Securities holdings of monetary policy-motivated bond purchase programmes declining

The scheduled ending on 31 October 2012 of the second covered bond purchase programme (CBPP2) implied the discontinuation, until further notice, of purchases by the Eurosystem as part of monetary policy-based bond purchase programmes. Since then, Eurosystem central banks' holdings of securities "for monetary policy purposes" have gradually declined as a result of maturing securities being redeemed. Securities holdings recorded as part of the Securities Market Programme (SMP) stood at €205.4 billion of late. A total of €65.1 billion was accounted for by the two covered bond purchase programmes. Until now, no purchases have been made in the form of Outright Monetary Transactions, the technical modalities of which were established by the ECB Governing Council in the third quarter of 2012.

Money market management and liquidity needs

During the three reserve maintenance periods from 10 October 2012 to 15 January 2013, euro-area credit institutions' need for central bank liquidity determined by autonomous liquidity factors rose by €52.8 billion in net terms. This higher need for liquidity was due, on the one hand, to the increased volume of banknotes in circulation, which accelerated significantly in line with the usual seasonal pattern for the Christmas period and reached an all-time high of just under €914 billion on 28 December 2012. Compared with period averages, the volume of banknotes in circulation augmented in the period under review by €10.8 billion in total. On the other hand, the sum of changes in net foreign assets and other factors induced a liquidity-absorbing effect. Taken together, ie adjusted for liquidity-neutral valuation effects, the resulting liquidity needs showed an increase of €43.3 billion in net terms. By contrast, general government deposits decelerated by €1.3 billion in net terms, which signified a slight reduction in liquidity needs. The minimum reserve requirement receded in the period under review, falling by a total of €1.0 billion.

During the three reserve maintenance periods under review, the Eurosystem also conducted liquidity-providing open market operations as fixed-rate tenders with full allotment of the submitted bids (see table on page 27). Therefore, credit institutions' demand for central bank liquidity was met in full, even though the overall liquidity supplied was still considerably higher than the needs resulting from autonomous factors and minimum reserve requirements. Credit institutions placed the existing excess liquidity – essentially an ongoing consequence of the high demand for liquidity during both three-year long-term refinancing operations (LTROs) at the end of December 2011 and the end of February 2012 – in the deposit facility on a daily basis, albeit only on a smaller scale. As in the preceding months, the banks left the larger part of excess liquidity in their current accounts, since they did not incur any opportunity costs due to the zero interest rate on the deposit facility that has been in place since mid-July 2012.

The amount of liquidity supplied via tender operations declined in the period under review. Consequently, there was a fall in credit institutions' demand in the main refinancing operations (MROs) (by €39 billion overall compared with period averages) as well as in their interest in the LTROs (a corresponding reduction of €26 billion in total). Together with the higher liquidity needs from autonomous factors, this resulted in a drop in excess liquidity, which was evident both in the perceptible decline in recourse to the deposit facility (-€67 billion) and in diminished credit institutions' current account holdings (-€49 billion). During the three periods under review, recourse to the marginal lending facility averaged €1.0 billion, €1.6 billion and €3.7 billion respectively, thus exceeding the averages of the preceding periods. In December, recourse to the marginal lending facility in the Eurosystem rose for a time to as high as €16 billion, but this was the result of short-term special effects.

On account of securities reaching maturity and the regular quarterly revaluation at the end of the quarter, the total balance sheet holdings of securities that had been purchased under the Securities Markets Programme (SMP) fell by just over €0.7 billion to €208.7 billion in the period under review. The SMP had been officially discontinued in September 2012. As securities in the SMP portfolio are held to maturity, however, the liquidity-providing effect resulting from this purchase programme continued to be neutralised – as decided by the ECB Governing Council when the SMP was introduced – through weekly liquidity-absorbing fine-tuning operations. It was only during the last SMP absorption tender of 2012 that slight underbidding occurred in the context that its maturity included the turn of the year. The holdings of the first Covered Bond Purchase Programme (CBPP), which had already ended as scheduled at the end of June 2010, decreased by around €2.8 billion to €51.4 billion in the period under review. By contrast, the balance sheet value of the second Covered Bond Purchase Programme (CBPP2) increased marginally by €37 million to €16.4 billion over the same period owing to fact that securities were bought under this programme until the end of October 2012, before it was likewise discontinued as planned.

In the October-November 2012 reserve maintenance period, demand in the MROs fell below the threshold of €100 billion for the first time since June 2012. However, there had already been evidence of a gradual decline in the course of the preceding months. The volume of the MROs averaged €84.4 billion over the period compared with €117.6 billion in the previous period. The outstanding volume from tender operations (excluding liquidity-absorbing fine-tuning operations) diminished in this period – strengthened through an equally low demand in the LTROs – to €1,138 billion on average (compared with €1,180 billion in the previous period). The share of the MROs in this total figure, which was further shaped by the liquidity arising from both three-year LTROs, thus dropped from 10.0% in the previous period to 7.4%. Contrary to the somewhat reduced demand for liquidity, autonomous factors accelerated to an average of €424 billion (€409 billion in the previous period). Compared with the previous period, average recourse to the deposit facility subsequently decreased by €49 billion to €256 billion, while excess reserves, ie current account holdings that exceed the reserve requirement, also receded to €423 billion an average (compared with €431 billion in the previous period). Credit institutions thus remained in favour of keeping a large part of the excess liquidity (62%), calculated from current account holdings plus the deposit facility minus the reserve requirement, in their current accounts as opposed to using the equally non-interest-bearing deposit facility. The EONIA, the reference rate for unsecured overnight money, showed a reduction over this reserve maintenance period and was fixed at an average of 0.088% (0.095% in the previous period), just over 66 basis points lower than the main refinancing rate. The underlying EONIA turnover was also down, averaging a volume of €22.3 billion compared with €25.4 billion in the previous period. Secured overnight money continued to be traded at a rate that was considerably lower than the EONIA. The corresponding average rate of Euro Repo's GC Pooling (ECB basket) over this reserve maintenance period stood at 0.015% (0.014% in the previous period) and was thus marginally higher than the deposit facility rate. GC Pooling overnight turnover accelerated to €11.6 billion on average compared with €8.5 billion in the previous period.

In the November-December 2012 reserve maintenance period, demand for liquidity was again down somewhat – both in the MROs and the LTROs. The overall tender volume from liquidity-providing open market operations averaged €1,118 billion. Moreover, autonomous factors showed a contrary development over this reserve maintenance period, growing by €23 billion on average to €447 billion. The average excess liquidity of €635 billion was spread over the

Factors determining bank liquidity[1]

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

Item	2012/2013		
	10 Oct to 13 Nov	14 Nov to 11 Dec	12 Dec to 15 Jan
I Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors			
1 Banknotes in circulation (increase: –)	+ 2.7	+ 0.7	– 14.2
2 Government deposits with the Eurosystem (increase: –)	+ 5.7	– 25.4	+ 21.0
3 Net foreign assets[2]	+ 27.0	– 0.5	– 24.1
4 Other factors[2]	– 50.4	+ 1.9	+ 2.8
Total	– 15.0	– 23.3	– 14.5
II Monetary policy operations of the Eurosystem			
1 Open market operations			
(a) Main refinancing operations	– 33.2	– 10.4	+ 4.2
(b) Longer-term refinancing operations	– 9.0	– 9.7	– 7.3
(c) Other operations	– 1.0	– 0.8	+ 1.4
2 Standing facilities			
(a) Marginal lending facility	– 0.1	+ 0.6	+ 2.1
(b) Deposit facility (increase: –)	+ 49.3	+ 24.3	– 6.6
Total	+ 6.0	+ 4.0	– 6.2
III Change in credit institutions' current accounts (I + II)	– 8.9	– 19.3	– 20.9
IV Change in the minimum reserve requirement (increase: –)	+ 0.6	+ 0.1	+ 0.3

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.
Deutsche Bundesbank

deposit facility (36%) and the excess reserves held in current accounts (64%). It was striking that the credit institutions' current account holdings were above average at the start of the period, only to then decline throughout most of the reserve maintenance period; a comparable trend was also observed in the previous period. Therefore, the banks continued to engage in a kind of frontloading, although this fulfilment behaviour had not necessarily been expected due to the consistently high current account holdings. The EONIA remained fairly constant at 0.073% on average over the reserve maintenance period, indicating a drop of 1.5 basis points compared with the corresponding rate of the previous period. At the same time, unsecured EONIA turnover also dropped to €19.4 billion on average and thus fell below the period-average €20 billion mark for the first time. Compared with the previous period, GC Pooling secured overnight rates remained virtually unchanged at 0.013% on average over this period, although the weighted overnight rate reached a new all-time low of 0.004% on 19 November 2012. The GC Pooling overnight turnover (ECB basket) was consistent with the level of the previous period at a daily average of €11.8 billion.

The developments observed in the preceding periods continued in the December 2012-January 2013 reserve maintenance period. First, the outstanding volume from tender operations (excluding liquidity-absorbing fine-tuning operations) declined again – albeit very slightly – to €1,115 billion on average, whereas autonomous factors rose to €461 billion on average. A period average of 38% of excess liquidity was spread over the deposit facility (€238 billion), while 62% thereof on average was distributed to excess reserves (€383 billion). It was notable, however, that current account holdings showed higher-than-average levels particularly at the start and end of the reserve maintenance period, and yet, at the turn of the year, reached record lows within the same period, whereas the deposit facility achieved a new period high at the end of 2012. In the last week before the turn of the year, there was – aside from the previously mentioned minor underbidding in connection with the SMP absorption tender – greater demand in the MROs (+€17 billion) compared with the previous week. Besides the period occurring around the turn of the year, another reason for this increase might have been the ECB Governing Council's decision to restore marketable debt instruments issued or fully guaranteed by the Greek government and fulfilling certain criteria as eligible collateral for the purposes of Eurosystem credit operations with effect from 21 December 2012. The turn of the year was likewise reflected in the overnight rates. Despite the high level of excess liquidity (€621 billion on average over the period), these rates rose perceptibly on 31 December 2012 in connection with the very low turnover: the EONIA was fixed at 0.131% (+5 basis points) at the end of the year and the GC Pooling weighted overnight rate (ECB basket) was also up by 5 basis points to 0.073%. However, the EONIA fixing at 0.071% was still lower than the rate of the previous period, while the overnight rate at GC Pooling averaged higher than the rate of the previous period at 0.020%. Overnight turnover went down, as usual for this time of year. Consequently, EONIA turnover only reached a daily average volume of €16.3 billion over this reserve maintenance period, while secured overnight turnover with GC Pooling (ECB basket) dropped to a period average of €8.3 billion. By comparison, these turnover figures were substantially greater in the corresponding reserve maintenance period of the previous year at €30.4 billion (EONIA) and €11.1 billion (GC Pooling) respectively.

Monetary policy refinancing volume down: early redemptions in first three-year tender

After reaching record highs in summer 2012, the monetary policy refinancing volume provided by the Eurosystem went down slightly in the fourth quarter. By 30 January 2013, banks were able for the first time to prematurely repay the liquidity received in the first three-year refinancing operation settled on 22 December 2011. Around €137 billion was returned on the first repayment date. No more than €3.5 billion and €5.0 billion were scheduled to be repaid early on the second and third repayment dates on 6 February and 13 February respectively. In particular institutions with excess central bank liquidity and more favourable alternative financing sources are likely to have made use of the early repayment opportunity. As expected, the use of refinancing operations with shorter maturities did not intensify in connection with early repayment.

The above reasons also caused excess liquidity – measured as deposit facility plus excess reserves – to fall by €135 billion after the repayment date to €487 billion compared with the average of the preceding maintenance period. Further repayments of still outstanding amounts from the first three-year refinancing operation may be made every week until final maturity. In future, the same will apply to the second three-year tender settled on 1 March 2012, for which early repayment will be possible from 27 February 2013.

Money market rates decline in 2012 Q4 …

On the one hand, the development of money market rates in the fourth quarter of 2012 was characterised by the high level of excess liquidity which continued to contribute to an – albeit slower – decline in unsecured Euribor rates. On the other hand, market participants' risk awareness appears to have diminished on the whole – which must also be seen against the backdrop of the announcement and implementation of supporting measures by governments and the Eurosystem designed to contain the sovereign debt crisis. This is likely to have benefited the stabilisation at a comparatively low

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
10.10.2012	MRO (FRT)	7	89.8	225.8	0.75	100.00	–	1.00	86
10.10.2012	FTO (–)	7	– 209.5	–	0.01	52.24	0.01	2.12	55
10.10.2012	S-LTRO (FRT)	35	12.6	–	0.75	100.00	–	1.00	27
17.10.2012	MRO (FRT)	7	91.8	301.3	0.75	100.00	–	1.00	96
17.10.2012	FTO (–)	7	– 209.5	–	0.01	51.27	0.01	2.00	60
24.10.2012	MRO (FRT)	7	77.3	286.3	0.75	100.00	–	1.00	93
24.10.2012	FTO (–)	7	– 209.5	–	0.01	50.60	0.01	2.03	60
31.10.2012	MRO (FRT)	7	83.7	261.7	0.75	100.00	–	1.00	87
31.10.2012	FTO (–)	7	– 209.5	–	0.01	58.46	0.01	1.93	56
01.11.2012	LTRO (FRT)	91	6.2	–	[4] 0.75	100.00	–	1.00	52
07.11.2012	MRO (FRT)	7	79.5	246.0	0.75	100.00	–	1.00	81
07.11.2012	FTO (–)	7	– 208.5	–	0.01	50.40	0.01	2.20	62
14.11.2012	MRO (FRT)	7	75.2	238.2	0.75	100.00	–	1.00	84
14.11.2012	FTO (–)	7	– 208.5	–	0.01	49.76	0.01	2.23	63
14.11.2012	S-LTRO (FRT)	28	15.9	–	0.75	100.00	–	1.00	30
21.11.2012	MRO (FRT)	7	75.4	268.4	0.75	100.00	–	1.00	85
21.11.2012	FTO (–)	7	– 208.5	–	0.01	51.39	0.01	2.16	63
28.11.2012	MRO (FRT)	7	74.6	207.1	0.75	100.00	–	1.00	79
28.11.2012	FTO (–)	7	– 208.5	–	0.01	58.34	0.01	1.92	60
29.11.2012	LTRO (FRT)	91	7.4	–	[4] …	100.00	–	1.00	37
05.12.2012	MRO (FRT)	7	70.8	265.8	0.75	100.00	–	1.00	74
05.12.2012	FTO (–)	7	– 208.5	–	0.01	56.50	0.01	2.00	53
12.12.2012	MRO (FRT)	7	73.2	219.2	0.75	100.00	–	1.00	82
12.12.2012	FTO (–)	7	– 208.5	–	0.01	57.90	0.01	1.94	57
12.12.2012	S-LTRO (FRT)	35	15.3	–	0.75	100.00	–	1.00	26
19.12.2012	MRO (FRT)	9	72.7	266.7	0.75	100.00	–	1.00	79
19.12.2012	FTO (–)	9	– 208.5	–	0.01	71.18	0.01	1.70	52
20.12.2012	LTRO (FRT)	98	15.0	–	[4] …	100.00	–	1.00	50
28.12.2012	MRO (FRT)	6	89.7	220.7	0.75	100.00	–	1.00	86
28.12.2012	FTO (–)	6	– 197.6	–	0.75	100.00	0.03	1.00	43
03.01.2013	MRO (FRT)	6	81.1	146.1	0.75	100.00	–	1.00	69
03.01.2013	FTO (–)	6	– 208.5	–	0.01	95.40	0.01	1.55	61
09.01.2013	MRO (FRT)	7	77.7	168.7	0.75	100.00	–	1.00	75
09.01.2013	FTO (–)	7	– 208.5	–	0.01	74.58	0.01	1.65	64

* For more information on the Eurosystem's operations from 11 July 2012 to 9 October 2012, see Deutsche Bundesbank, Monthly Report, November 2012, p 33. **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).
Deutsche Bundesbank

level of interest rate spreads between unsecured and secured money market rates (depo-repo spreads) in the fourth quarter.

… and broad-based increase at the start of 2013 for the first time in a while

Given the decision of the ECB Governing Council to keep key interest rates at the current levels and in the light of market participants' expectations regarding a further reduction in excess liquidity – probably also in view of the opportunity to make further early repayments of the three-year refinancing operations – a more broad-based increase in money market rates could be observed for the first time in a while across all market segments and maturities in January 2013. This increase occurred against the backdrop of largely constant depo-repo spreads. The Eurepo rates reported by the surveyed institutions for interbank money market operations backed by the best collateral are now back in positive territory again across the entire maturity spectrum.

ECB Governing Council notes Central Bank of Ireland's approach to IBRC liquidation

At its last meeting, the ECB Governing Council took note of the remarks by the Governor of the Central Bank of Ireland regarding the treatment of state-owned Irish Bank Resolution Corporation (IBRC), which the Irish government had liquidated shortly before. The Irish central bank had granted emergency liquidity assistance to IBRC, as a result of the liquidation of

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

Changes in € billion, seasonally adjusted

Assets	2012 Q4	2012 Q3	Liabilities	2012 Q4	2012 Q3
Loans to non-MFIs in the euro area	− 21.1	− 7.8	Central government deposits	− 3.1	14.1
of which			Monetary aggregate M3	65.6	57.5
General government	− 16.2	− 6.7	*of which:* Components		
Private non-MFIs[1]	− 4.9	− 1.2	Currency in circulation and overnight deposits (M1)	63.1	127.1
Lending in the form of securities to non-MFIs in the euro area	36.4	1.8	Other shorter-term bank deposits (M2-M1)	45.8	− 37.4
of which			Marketable instruments (M3-M2)	− 43.3	− 32.1
General government	2.2	49.4	Monetary capital	− 29.1	− 5.9
Private non-MFIs	34.2	− 47.6			
Net external assets	124.9	18.4			
Other counterparts of M3	− 106.9	53.4			

* Changes for statistical reasons eliminated. **1** Adjusted for loan sales and securitisation.
Deutsche Bundesbank

which the central bank assumed full ownership of the relevant collateral. The Irish government and the country's central bank subsequently agreed, among others, that the Irish government's promissory notes which formed part of the collateral would be swapped for longer-term Irish government bonds with a lower coupon. The Irish central bank ultimately pays interest on the new bonds to the rest of the Eurosystem at the main refinancing rate, while the Irish government's interest payments are collected as net income and can be used for distributions to the government afterwards. This approach confirms the increasingly close and problematic ties between monetary and fiscal policy in the European monetary union. Responsibility for providing any assistance to individual member states in servicing their sovereign debts should lie with the European Stability Mechanism (ESM), which was established for that purpose.

Monetary developments in the euro area

Moderate monetary growth continues

On balance, the broad monetary aggregate M3 continued its moderate growth of the two previous quarters in the autumn quarter of 2012. This monetary expansion was driven by continued portfolio shifts by the money-holding sector away from longer-term and securitised investments in favour of short-term bank deposits. Decisive factors are likely to have been the overall low interest rate level and the flattening of the yield curve. In contrast, lending to the private sector in the euro area remained weak for the fifth consecutive quarter. This meant that the annual growth rates of the monetary aggregate and loans remained decoupled: whilst M3 increased from 2.6% in the third quarter to 3.3% in the fourth, the annualised growth rate for loans to the domestic private sector (adjusted for loan sales and securitisation) remained in negative territory at -0.2%.

Strong build-up of short-term deposits

Given the general calming in the financial markets, sight deposits became less relevant for M3 growth in the reporting quarter. Although overnight deposits contained in M1 still grew by just under €66 billion in the reporting quarter, almost one-half of this increase was due to the ESM investing member states' paid-up common shares in the MFI sector. The decreasing relevance of sight deposits was compensated for by significant inflows to the other short-term bank deposits (M2-M1). Not only short-term savings deposits but also short-term time deposits – which had decreased substantially in spring and summer – were built up during the autumn months. The rising demand for short-term time deposits was driven by the corporate sector and households alike. The inflows to short-term time deposits and savings deposits were promoted by relatively favourable interest rate developments compared with longer-term investments. A contributory factor was that banks in the peripheral countries, especially in Spain, were advertising attractive interest rates for short-term time deposits.

In contrast, renewed acceleration in cutback of marketable financial instruments

The money-holding sector's portfolio shifts also affected the bank debt securities contained in M3-M2 with a maturity of up to two years, the cutback of which was accelerated again in the autumn months. Larger-scale redemption activities in individual euro-area countries played a role, too. The increase in M3 was dampened, moreover, by further declines in money market fund shares, which became a great deal less attractive given the low-interest rate environment.

Increase in M3 supported by reduction in monetary capital

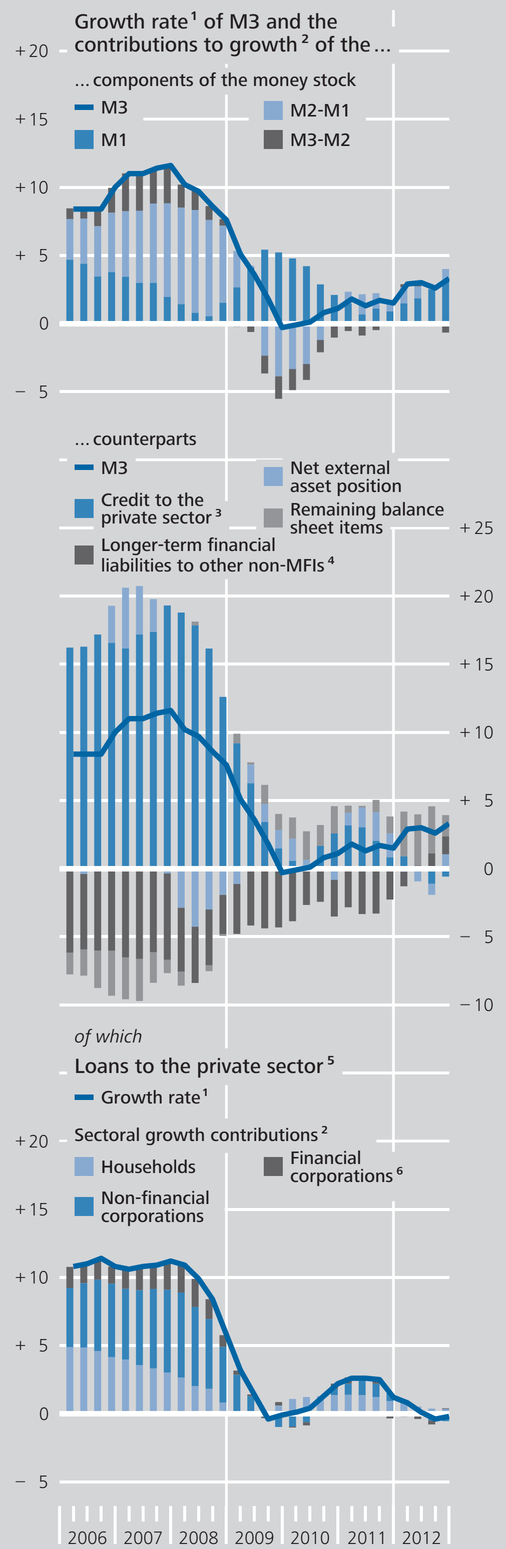
The increase in M3 in the autumn quarter was supported by the continued reduction in longer-term financial liabilities of the MFIs vis-à-vis other sectors in the euro area. An important contribution to this was made by net redemptions of long-term bank debt securities in peripheral and core countries of the euro area alike. Furthermore, savings deposits with an agreed notice period of over three months, too, recorded outflows, which are likely to be connected to the flattening yield curve.

Substantial rise in net external assets

The strongest expansionary effect on monetary developments in the euro area in the reporting quarter was, however, exerted by a rise in the banking sector's net external asset position vis-à-vis non-residents. Besides the continued excess in current account balances, this rise reflected, above all, international investors' portfolio shifts in favour of the euro area. It was non-resident investors, in particular, who acquired securities issued by domestic non-banks; this was also reflected in the decline in securitised lending by German banks to the domestic private sector that occurred in October and November.

Components and counterparts of the money stock in the euro area

Seasonally adjusted, end-of-quarter data



1 Year-on-year change in per cent. **2** In percentage points. **3** Adjusted for loan sales and securitisation. **4** Taken in isolation, an increase curbs M3 growth. **5** Adjusted for loan sales and securitisation from 2010 Q1. **6** Non-monetary financial corporations.

Deutsche Bundesbank

Securitised lending to private sector strongly influenced by special factors

Although monetary statistics for the reporting quarter indicate an overall expansion in securitised lending by the MFI sector to the private sector, this expansion is solely attributable to the high inflows of December 2012, which were directly linked to the orderly restructuring of the Spanish banking sector. Spanish banks transferred a relatively large amount of loans to the Spanish resolution unit Sareb – which is, statistically speaking, part of the financial corporations sector – and in return received securities issued by that unit. Moreover, the rise in securitised lending can be explained by inflows to the Spanish banking sector in connection with the recapitalisation of ESM bonds in the amount of €40 billion.

Decline in lending to general government has dampening effect

In contrast to the previous quarters, lending by the MFI sector to general government had a dampening effect on monetary growth in the reporting quarter. Whereas MFIs had increasingly acquired securities of sovereign issuers in the preceding quarters, this form of lending stagnated on balance in the autumn quarter of 2012. This was essentially due to the sale of government securities in December 2012 and affected banks throughout the euro area, which potentially also implies effects of balance sheet cleansing.

Loans to private sector treading water again

Loans to private non-banks in the euro area – adjusted for loan sales and securitisation – trod water again in the final quarter of 2012. However, this was attributable to various sectoral developments. In addition, the provision of loans in the individual euro-area member states continued to be very heterogeneous, which was mostly due to weakening economic activity, increased uncertainty among borrowers, and balance sheet consolidations in some euro-area countries.

Renewed reduction in loans to non-financial corporations

There was a reduction – which was most pronounced in December – in loans to non-financial corporations in the euro area throughout the reporting period; loans with medium and long-term maturities were particularly affected. The seasonally adjusted and annualised three-month rate of loans to non-financial corporations in the euro area went down from just over -1½% in the previous quarter to -3% in the reporting quarter. The decline in this subaggregate was, however, overshadowed by negative effects from the orderly restructuring of the Spanish banking sector. Balance sheet cleansing effects in the financial statements are also likely to have played a role. With the exception of Spain, no further decrease was recorded in year-on-year rates of loans to non-financial corporations in countries particularly affected by the sovereign debt crisis.

Further expansion in loans to financial corporations and households, however

The clear reduction in loans to non-financial corporations was balanced out in the reporting quarter by a marked expansion in loans to financial corporations along with a moderate build-up of loans (adjusted for loan sales and securitisation) to households. In the case of households, on balance, inflows – as in the previous quarters – stemmed from loans for house purchase, which make up the lion's share of household borrowing. Continued outflows in this credit segment in the peripheral countries (excluding Ireland) were once again more than offset by considerable inflows in other countries, notably in Germany and France. However, the reduction in consumer credit continued, which meant that the seasonally adjusted and annualised three-month rate of loans to households remained subdued at just under 1%.

Money-based forecasts with balanced inflation risks

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

German banks' deposit and lending business with domestic customers

German banks' deposit business – which had already lost considerable momentum in the

Decline in deposit business essentially caused by special factor

previous quarter – posted a sharp decline in the final quarter of 2012. However, the bulk of this decline was due to a resolution agency assigned to the general government sector liquidating sight deposits and short-term time deposits in the overall amount of around €28 billion in December 2012. This was linked to balance sheet restructuring measures being carried out. But the private non-banks that had been building up deposits in the previous quarter also withdrew funds from the MFI sector on balance in the reporting quarter.

Unlike in the rest of the euro area, corporations and households in Germany once again reduced short-term time deposits in the autumn months. Above all, this was probably due to the relatively unattractive rate of interest on this form of investment in Germany. However, given that, at the same time, sight deposits of corporations and households were clearly up again, the private sector on balance continued its portfolio shifts away from long-term into shorter-term types of deposits.

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

Changes in € billion, seasonally adjusted

Item	2012 Q3	2012 Q4
Deposits of domestic non-MFIs 1		
Overnight	42.4	32.0
With agreed maturities		
of up to 2 years	– 20.0	– 48.2
of over 2 years	– 8.7	– 15.6
Redeemable at notice		
of up to 3 months	4.7	2.0
of over 3 months	– 3.3	– 5.2
Lending		
to domestic general government		
Loans	– 10.5	– 10.0
Securitised lending	14.0	4.4
to domestic enterprises and households		
Loans	10.0	5.9
of which to households 2	3.9	5.9
to non-financial corporations 3	6.0	– 2.5
Securitised lending	4.1	– 5.7

* As well as banks (including building and loan associations, but excluding the Bundesbank), monetary financial institutions (MFIs) here also include money market funds. End-of-quarter data, adjusted for statistical changes. 1 Enterprises, households and general government excluding central government. 2 Including non-profit institutions serving households. 3 Corporations and quasi-corporations.

Deutsche Bundesbank

Renewed decline in longer-term deposits, only partly in favour of sight deposits

These portfolio shifts caused longer-term time deposits with a maturity of over two years to fall substantially once again. Above all, insurers and other financial intermediaries were responsible for this decline, while their demand for sight deposits increased at the same time – albeit to a lesser extent. Savings deposits with longer periods of notice, too, declined again in the reporting quarter against the backdrop of the even lower interest rate spread between longer-term investments and sight deposits. Movements in this market segment are usually almost exclusively attributable to portfolio decisions of households, which again favoured sight deposits on a larger scale.

Perceptible decrease in banks' lending to domestic non-banks

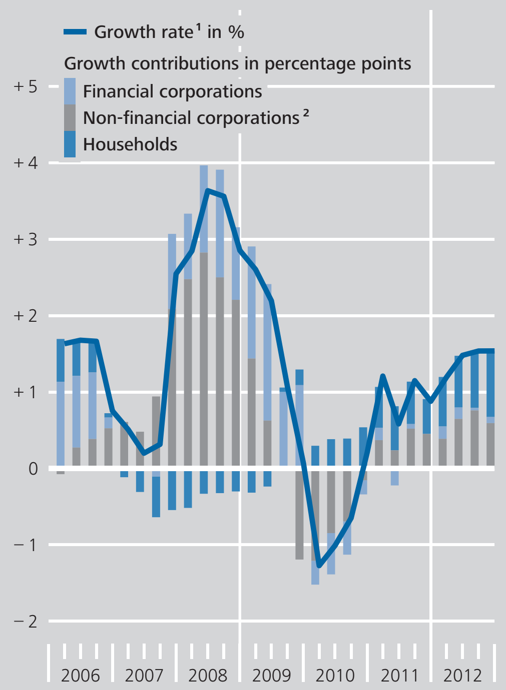
Lending by German banks to domestic non-banks failed to sustain the growth trend it had embarked upon at the start of last year, diminishing perceptibly in the quarter under review. The (seasonally adjusted and annualised) decrease of just over -½% on the quarter was primarily due to a distinct reduction in loans to general government, which could not be offset by the only moderate increase in holdings of securities issued by domestic general government. In addition, credit institutions also reduced their securitised lending to the private sector perceptibly.

Discernible reduction in loans to non-financial corporations

Loans to the domestic private sector posted a slight increase that was driven solely by a rise in loans to financial corporations and households. Meanwhile, loans to non-financial corporations, which had expanded distinctly in the first three quarters, fell discernibly in the final quarter of 2012, regardless of the still low lending rates. While the seasonally adjusted and annualised three-month rate for loans to non-financial corporations fell substantially in the reporting quarter to just over -1% from +3% in the previous quarter, the annual growth rate went down only moderately to 1.7%, compared with 2.2% at the end of September. In particular short-term loans declined in the reporting quarter, whereas loans with longer-

Loans of German banks to selected sectors

Seasonally adjusted, end-of-quarter data



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

term maturities stagnated. Besides the persistent weakness of investment in machinery and equipment, net redemptions in this credit segment are also likely to be partly attributable to non-financial corporations cleansing their balance sheets at year-end.

Moderate growth in loans to households solely driven by loans for house purchase

Unlike loans to non-financial corporations, loans to domestic households went up on balance in the final quarter of 2012, although lending markedly lost momentum in December. Hence, at just over 1½%, seasonally adjusted and annualised growth remained moderate on the whole. The 12-month rate for loans to households, too, edged up only slightly from +1.2% in the previous quarter to +1.4%. As for the euro-area aggregate, this increase in lending was solely driven by a renewed expansion in loans for house purchase, which climbed to a seasonally adjusted and annualised rate of 2½% in the reporting quarter. Consumer credit and other lending stalled, however. On the whole, the increase in loans to households was primarily driven by savings banks, credit cooperatives and regional banks.

German banks' credit standards vis-à-vis corporations somewhat tighter

The German banks participating in the Bank Lending Survey slightly tightened their credit standards for business with non-financial corporations in the last quarter of 2012. This particularly affected lending to large enterprises. The surveyed institutions indicated that the restrictive adjustments were owed to a deterioration in the general economic outlook as well as sector and company-specific factors. Unlike in the previous quarter, higher capital costs virtually no longer played a role. Furthermore, survey participants widened their margins distinctly vis-à-vis both average and risky borrowers.

Slight streamlining in standards for private loans for house purchase

At the same time, bank managers applied somewhat stricter standards for private housing loans, while slightly loosening their standards for consumer credit and other lending to households. In addition, bank managers widened the margins for riskier housing loans as well as for consumer credit in both credit rating categories.

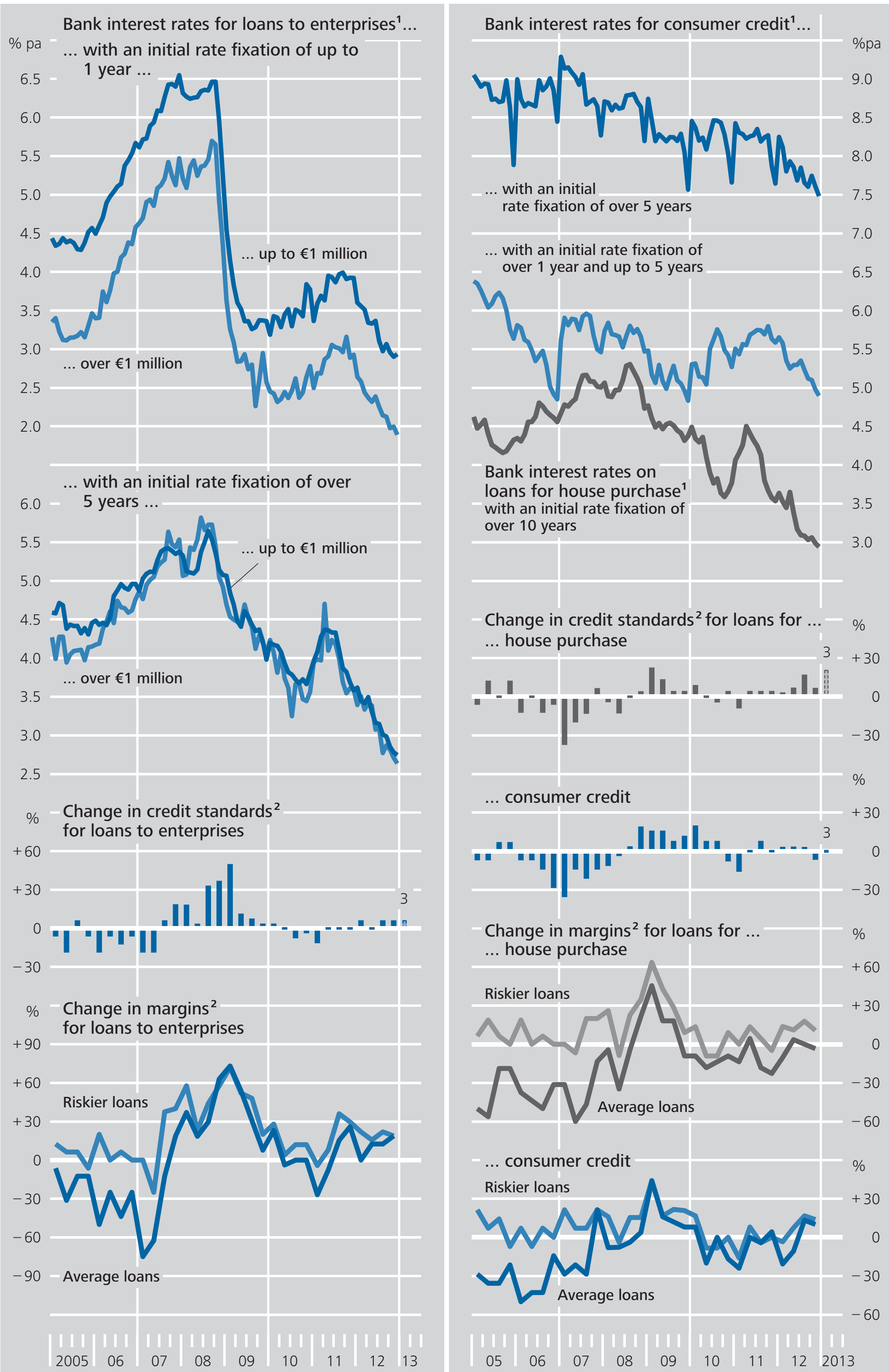
Trend increase in demand for private loans for house purchase continues

Furthermore, survey participants reported that the sustained trend towards a growing demand for housing loans since the beginning of the sovereign debt crisis continued in the last quarter of 2012. The surveyed banks attributed this, above all, to the still highly optimistic outlook on the housing market, persistently strong consumer confidence and low interest rates. Demand for consumer credit, too, increased slightly, while non-financial corporations' demand for funds was largely stagnant.

Improvement in German banks' funding situation in the final quarter

The Bank Lending Survey contained two additional questions on the impact of the financial and sovereign debt crisis on the banks' funding conditions and credit standards as well as on the measures taken and envisaged to meet the stricter regulatory requirements under the European Capital Requirements Directive (CRD) IV. According to the information provided by the participating institutions, their funding situ-

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 Q1.

Deutsche Bundesbank

ation improved markedly overall in the fourth quarter of 2012. Individual survey participants indicated that this was also due to easing tensions in sovereign debt markets. This, however, did not influence their lending policy.

Capital position strengthened and risk-weighted assets reduced in run-up to CRD IV

In addition, the surveyed banks stated that risk-weighted assets were reduced markedly in the second half of 2012 as a result of stricter capital requirements. In the credit book, this mainly affected riskier borrowers. Moreover, survey participants strengthened their capital position and intend to continue on this path in the first half of 2013, above all by retaining profits. Given the tightened regulation, the surveyed institutions applied stricter standards to loans to large enterprises in particular and distinctly widened their margins in this line of business. The surveyed institutions expect this development to intensify once again in the first half of 2013.

Lending policies in the euro area tightened

The euro area, too, saw an overall tightening of credit standards in the fourth quarter of 2012. This was due both to the somewhat more restrictive bank-related factors and, above all, to a deterioration in the institutions' perception of risk. At the same time, demand fell again considerably in all surveyed business lines. By contrast, according to data provided by the European survey participants, their funding situation improved in the final quarter. Taken in isolation, the sovereign debt crisis now produced only marginally negative effects which, on the whole, did not influence the setting of credit standards and margins. Preparations for the stricter capital requirements were largely in line with those of the German subsample.

Bank interest rates in Germany down again

The final quarter of 2012 saw a renewed decline in bank lending rates across almost all business areas, maturities and volumes, thus reflecting the general downward trend in interest rates on the money and capital markets. Interest rates for long-term fixed-interest loans to enterprises stood at 2.7% for small-scale loans and at 2.6% for large-scale loans in the same category, ie once again more than 20 basis points lower than at the end of September 2012. In addition, conditions for private loans for house purchase with an initial rate fixation of over ten years fell by 9 basis points, reaching a new record low of 2.9% since the statistics were introduced in 2003. Long-term consumer credit, too, was more favourably priced. In this case, quarter-on-quarter interest rates declined by 12 basis points to 7.5%. Consumer credit with an initial rate fixation of up to one year became cheaper by as much as 50 basis points compared with the end of September 2012, not least as a result of seasonal effects, and reached 3.9%. Moreover, deposits of households and non-financial corporations also consistently earned clearly less interest than just a quarter earlier.