Monetary policy and banking business

Monetary policy and money market developments

Key interest rates remain at all-time low

In line with its forward guidance, during the reporting period, the Governing Council of the ECB kept key euro-area interest rates at the levels reached following the interest rate cut of 4 September 2014, which it considers the lower bound. Therefore, the main refinancing rate remains at 0.05%, the marginal lending rate at 0.30% and the deposit rate at -0.20%.

ECB Governing Council adopts expanded asset purchase programme and lowers interest rate on longer-term refinancing operations

On 22 January 2015, the Governing Council of the ECB announced the launch of an expanded asset purchase programme (EAPP). It also decided to lower the interest rate for the six remaining targeted longer-term refinancing operations (TLTROs) to the level of the main refinancing rate, thereby removing the 10 basis point spread that was required in the first two operations.

The majority of the ECB Governing Council regarded the EAPP as being necessary to fulfil the Eurosystem's price stability mandate. The reasoning behind this was, first, that recent inflation dynamics were again weaker than originally expected, as reflected by the decline in annual HICP inflation to -0.2% in December 2014. In addition, market-based indicators of medium to long-term inflation expectations had continued to fall, leading to assumptions that annual HICP inflation might also be low or negative in the next few months owing to dampened energy price developments. Finally, the degree of monetary accommodation created through the measures adopted between June and September 2014 was considered insufficient to address the increased risks of too prolonged a period of low inflation.

Under the EAPP, the Eurosystem's covered bond purchase programme (CBPP3) and asset-backed securities purchase programme (ABSPP), which were launched in September 2014, will be continued at the same conditions. From March 2015, purchases will be expanded to include bonds issued by euro-area central governments, agencies and European institutions. The additional bonds to be purchased as part of the programme can have maturities of between two and 30 years. Ultimately, the Eurosystem will not purchase more than 25% of each issue so as not to obstruct the application of collective action clauses (CACs). The Eurosystem will accept the same treatment as private investors. Moreover, it will not hold more than 33% of each issuer's debt in total, ie including other Eurosystem portfolios. The monthly purchase volume under the EAPP, including the ABSPP and CBPP3, is to total €60 billion and this volume is to be maintained until the end of September 2016 or, in any case, until the Governing Council sees a sustained adjustment in the path of inflation that is consistent with its aim of achieving inflation rates below, but close to, 2% over the medium term. As in the case of CBPP3, the purchase of public-sector debt instruments also generally requires a minimum credit assessment equivalent to an external rating agency's rating of BBB-. Bonds issued by countries that do not meet this credit rating requirement are exempt from this rule if the minimum credit quality threshold for acceptable collateral from the country in question has been suspended for monetary policy operations. This is the case if a country is undergoing an EU/IMF adjustment programme and meets the programme conditions.

Programme to start in March 2015 with monthly purchase volume of €60 billion

Additional asset purchases only partially subject to risk-sharing regime

The ECB Governing Council has also decided that any losses arising from the purchase of securities of European institutions, which account for 12% of the additional asset purchases and are purchased by the national central banks, will be subject to loss sharing. The ECB will purchase 8% of the remaining assets, which will also be subject to the risk-sharing regime, while the rest of the securities will be purchased in a decentralised manner by the

Money market management and liquidity needs

The three reserve maintenance periods from 8 October 2014 to 27 January 2015 saw a marked increase in euro-area liquidity needs stemming from autonomous factors. In the December 2014-January 2015 reserve period, the figure averaged €505.2 billion, which was €30.1 billion higher than in the September-October 2014 reserve period. At €34.2 billion, this was primarily driven by the sharp rise in banknotes in circulation – particularly before Christmas – typical of the season. By contrast, the €12.1 billion net decline in government deposits with the Eurosystem served to provide liquidity, while the aggregate decrease in the remaining autonomous factors (including net foreign assets) totalling €8.0 billion had a liquidity-absorbing effect. The increase in minimum reserve requirements triggered an additional €0.8 billion rise in the calculated liquidity needs (see table below).

The outstanding volume of tender operations fluctuated greatly between €484 billion and €629 billion during the period under review (see chart on page 26). On the one hand, these fluctuations were driven in particular by the increased bids in main refinancing operations towards the end of the month, accompanied by a higher number of bidders. On the other hand, the second targeted longer-term refinancing operation (TLTRO) allotment had a more noticeable impact. As at 17 December 2014, around €130 billion had been credited, although the outstanding tender volume only experienced a net increase of €84 billion that day due to funds shifted from the main refinancing operation and early repayments of liquidity provided in the three-year LTROs. Overall, the early repayments in the three reserve maintenance periods under review came in at a high figure of €135 billion (compared to a total of €87 billion in the

Factors determining bank liquidity*

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

Item	2014/2015 8 Oct to 11 Nov	12 Nov to 9 Dec	10 Dec to 27 Jan
I Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors			
1 Banknotes in circulation (increase: –)	– 2.3	– 6.2	– 25.7
2 Government deposits with the Eurosystem (increase: –)	+ 2.3	+ 4.4	+ 5.4
3 Net foreign assets[1]	+ 10.0	+ 2.3	+ 12.1
4 Other factors[1]	– 16.9	– 7.5	– 8.0
Total	– 6.9	– 7.0	– 16.2
II Monetary policy operations of the Eurosystem			
1 Open market operations			
(a) Main refinancing operations	– 3.7	+ 8.1	+ 15.7
(b) Longer-term refinancing operations	+ 14.3	– 16.4	+ 58.3
(c) Other operations	– 1.4	+ 8.7	+ 15.9
2 Standing facilities			
(a) Marginal lending facility	+ 0.1	– 0.1	+ 0.3
(b) Deposit facility (increase: –)	– 6.7	+ 3.7	– 22.9
Total	+ 2.6	+ 4.0	+ 67.3
III Change in credit institutions' current accounts (I + II)	– 4.3	– 2.9	+ 50.9
IV Change in the minimum reserve requirement (increase: –)	– 0.4	– 0.7	+ 0.3

* For longer-term trends and the Bundesbank's contribution, see pp 14• and 15• of the Statistical Section of this Monthly Report. 1 Including end-of-quarter liquidity-neutral valuation adjustments.

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three previous periods), with the approaching maturities also making a contribution.

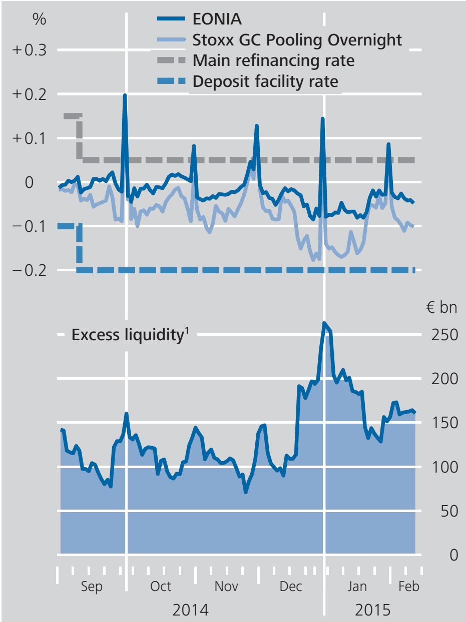
Banks received additional liquidity from new purchases that commenced in October and November 2014 under the purchase programmes CBPP3 and ABSPP. By 23 January 2015, purchases under these programmes had reached on-balance-sheet levels of €37.2 billion (CBPP3) and €2.3 billion (ABSPP). At the same time, the balance sheet holdings of securities acquired through purchase programmes already completed fell further during the period under review as a result of maturities and taking into account end-of-quarter revaluations (CBPP1 and CBPP2 declined by €4.0 billion to €27.8 billion and by €0.8 billion to €12.7 billion respectively, while the SMP volume was down by €4.9 billion to €144.3 billion).

As a consequence of fluctuations in autonomous factors (between €465 billion and €564 billion) and changes in demand for liquidity, excess liquidity also proved volatile. At €71 billion, excess liquidity hit its lowest level on 24 November 2014. Its highest point, €263 billion, was reached on 1 January 2015, as credit institutions had increased their liquidity buffers at the end of the year to meet, *inter alia,* their balance sheet or regulatory requirements. While average excess liquidity in the two previous periods was rather low, at €114 billion and €106 billion respectively, it rose sharply to €180 billion (compared to €145 billion in 2013) during the Christmas maintenance period. With an extended duration of 49 days, this was also the first reserve maintenance period to occur under the new cycle implemented for the ECB Governing Council's monetary policy meetings.

With the exception of the month-end rates, overnight rates also fluctuated in the three reserve maintenance periods under review between the main refinancing rate and the deposit facility rate, although secured overnight money (GC Pooling Overnight, ECB basket) remained consistently below EONIA, by 5 basis points on average in this period (by 3 basis points in the three previous periods) (see charts above). After the period averages of both EONIA and the secured overnight rate had remained at approximately the same level in the first two

Central bank interest rates, money market rates and excess liquidity

Daily data



Sources: ECB, Eurex Repo and Bundesbank calculations. **1** Current account holdings minus the minimum reserve requirement plus the deposit facility.
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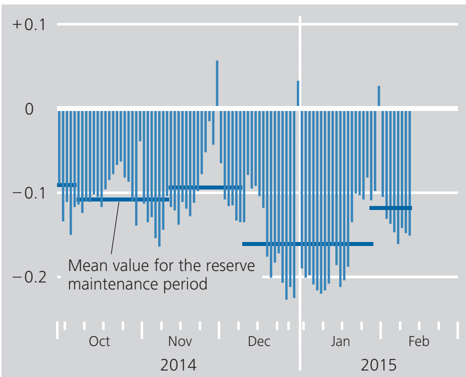
Spread between Stoxx GC Pooling Overnight and the main refinancing rate

Percentage points, daily data



Sources: ECB, Eurex Repo and Bundesbank calculations.
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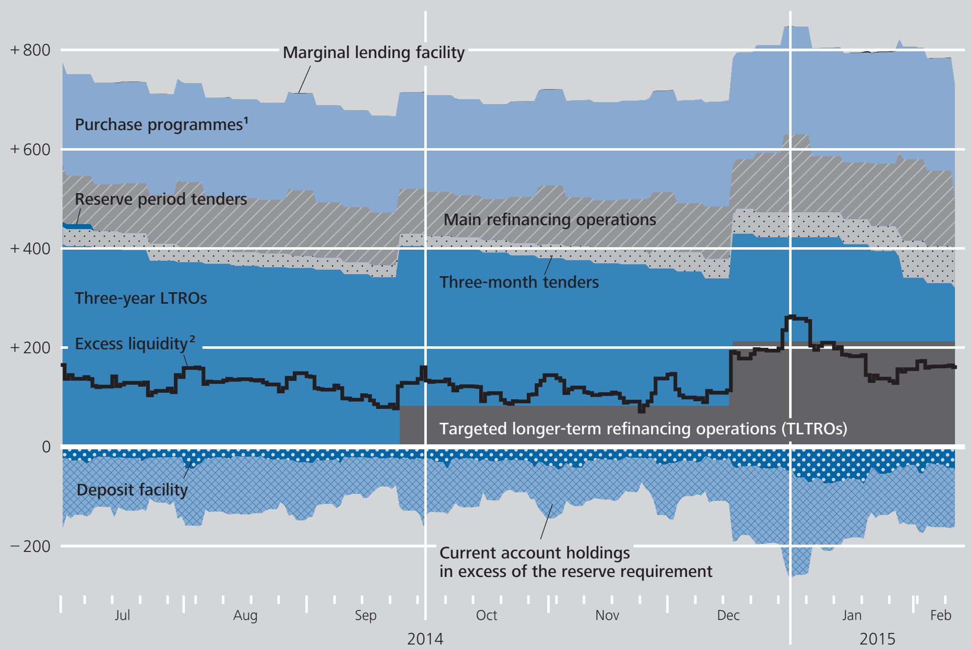
Liquidity provision and use

€ billion, daily data



Sources: ECB and Bundesbank calculations. 1 Securities Markets Programme (SMP), Covered Bond Purchase Programmes (CBPP1, CBPP2 and CBPP3) and Asset-Backed Securities Purchase Programme (ABSPP). 2 Current account holdings minus the minimum reserve requirement plus the deposit facility.

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periods as in the September-October 2014 period, they both experienced a marked drop in the December 2014-January 2015 reserve period in light of the significant increase in excess liquidity. EONIA fell to -0.05% on average for the period (-0.01% in the two previous periods), and the secured overnight rate to -0.11% on average (-0.06% and -0.04% in the previous periods). On 24 December 2014, both EONIA and GC Pooling Overnight reached new all-time lows at -0.085% and -0.177% respectively. For the period under review, the underlying turnover on the overnight market was consistently lower on average than the levels recorded in the September-October 2014 period. While the corresponding turnover on GC Pooling (ECB basket) sank to an average of €14.7 billion in the December 2014-January 2015 reserve period (€19.9 billion in September-October 2014), EONIA turnover ended its downward trend in this reserve maintenance period. This was primarily the result of increased turnover from mid-January onwards, which ultimately led to an average of €27.4 billion for the period. One reason for this rise in EONIA turnover may have been that the first three-year LTRO matured on 29 January 2015, as the remaining €39 billion of the €489 billion originally allotted expired at the beginning of the January-February 2015 reserve period. However, this maturity had little effect on the outstanding tender volume because credit institutions had obtained more liquidity in return through higher demand for the main refinancing operation and for the three-month LTRO, which was settled the same day. In the last week of January, these shifts led to a net rise of €9 billion in the Eurosystem's outstanding tender volume to €579 billion. Overall, until the additional purchases under the expanded asset purchase programme (EAPP) begin in March 2015, and settlement of the third TLTRO takes place on 25 March 2015, increased volatility in excess liquidity can be expected.

national central banks. The other assets purchased by the national central banks will not be subject to loss sharing, meaning that for a total of 80% of the additional assets purchased under the EAPP following the decision of 22 January 2015, any losses sustained by a national central bank will not be shared among the members of the Eurosystem.

Risk of downward spiral of prices and wages is low

Price developments, which are subdued at present, pose a challenge to monetary policymakers because inflation figures at the current end are a long way off the target of 2%, and projections over the typical monetary policy horizon do not suggest a rapid return to this level. However, this is mainly due to a sharp fall in oil prices, which is likely to boost economic activity as households' disposable income goes up and enterprises' profits rise. In addition, adjustment processes in a number of euro-area countries are currently suppressing price developments in the euro area as a whole. This reflects the necessary restoration of competitiveness in the countries in question and is therefore also a positive sign. Although inflation rates are currently very low, both these factors suggest that the risk of deflation in the sense of a negative downward spiral of prices and wages is currently small.

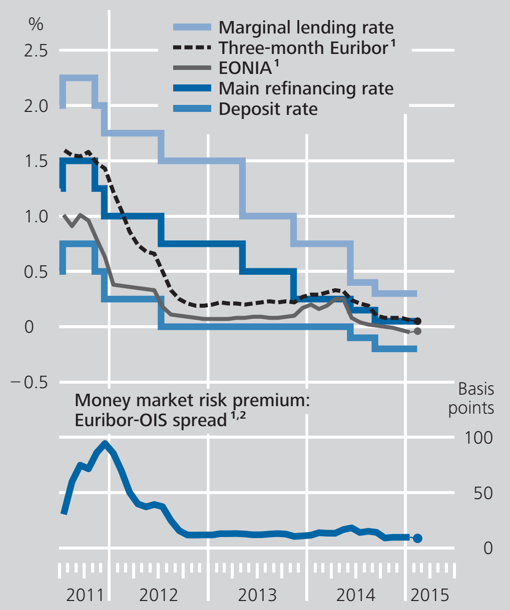
Eurosystem continues purchase programmes for asset-backed securities (ABSPP) and covered bonds (CBPP3)

The Eurosystem began purchasing asset-backed securities (ABS) at the end of November 2014; by 6 February 2015, €2.7 billion worth of ABS had been acquired. Under the covered bond purchase programme (CBPP3), bonds worth a total of €42.9 billion had been purchased on the primary and secondary market by 6 February 2015.

Lithuania joins euro area; rotating system of voting rights introduced for ECB Governing Council

Lithuania joined the euro area at the beginning of 2015. Lithuania's accession to the Eurosystem triggered the rotating system of voting rights in the Governing Council of the ECB, starting from 1 January 2015. Under this system, the group of governors representing the national central banks of the euro area's largest member states, which includes the Bundesbank president as well as the governors of the

Money market interest rates in the euro area



Source: ECB. 1 Monthly averages. 2 Three-month Euribor less three-month EONIA swap rate. The three-month Eurepo rate used hitherto was discontinued on 1 January 2015. See also Deutsche Bundesbank, Money market risk premia: indicators for the state of the interbank market, Monthly Report, August 2014, pp 30-31. • Average 1 to 12 February 2015.

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Spanish, French, Italian and Dutch central banks, take turns in relinquishing their voting rights in the ECB Governing Council for one month.

ECB Governing Council makes new decision on eligibility of Greek bonds

On 4 February 2015, the Governing Council of the ECB decided to lift the waiver of minimum credit rating requirements for marketable instruments issued or guaranteed by Greece. This waiver had allowed such instruments to be used in Eurosystem monetary policy operations despite the fact that they did not fulfil minimum credit rating requirements. The Governing Council's decision is based on the fact that it is currently not possible to assume a successful conclusion of the programme review, and is in line with existing Eurosystem rules. As a result, funding of the Greek banking system shifted away from monetary policy refinancing towards emergency liquidity assistance (ELA). This consists of short-term assistance provided by Eurosystem national central banks to solvent financial institutions facing temporary liquidity problems. The Greek banks receiving ELA should therefore take measures to improve their liquidity position. An expansion of liquidity needs as a result of purchasing short-term Greek government debt in the coming weeks would run counter to this.

306 banks borrow €129.9 billion in second TLTRO

The second of eight TLTROs was carried out on 11 December 2014. In this operation, 306 institutions borrowed an overall volume of €129.9 billion from the Eurosystem. The amount borrowed in the first two tenders came to €212.5 billion in total. In the first two TLTROs, participating banks were able to take out central bank loans amounting to up to 7% of their outstanding credit volume to the non-financial private sector (not including loans to households for house purchase) as at 30 April 2014. Overall, banks made use of around 50% of this upper limit. A further six TLTROs will be conducted up until June 2016, allowing counterparties to borrow up to three times the amount of their eligible net lending above a certain benchmark.

Marked rise in excess liquidity at the turn of the year

The refinancing volume and excess liquidity rose sharply at the turn of the year as a result of an increase in banks' demand for liquidity. After rising considerably following the second TLTRO on 17 December 2014, both variables also continued to climb until the end of the year owing, *inter alia,* to greater recourse to other monetary policy refinancing operations. As in previous years, the increase in demand for liquidity probably resulted from the banking system's tendency to hold liquidity buffers at year-end and banks actively shaping their balance sheets to comply with internal and regulatory requirements.

Having reached around €260 billion at the beginning of January 2015, its highest level since the turn of the last year, excess liquidity decreased again markedly throughout January. The major factors that influenced this were a temporary decline in the main refinancing volume, early repayments of liquidity in both three-year tenders and the maturity of the first of these operations on 29 January 2015. However, excess liquidity has gone back up of late owing to further purchases by the Eurosystem under the ABSPP and CBPP3 programmes and a significant pick-up in main refinancing operations.

Short-term money market rates temporarily reach new lows

Consistent with the rise in excess liquidity, short-term money market rates reached new lows in December and January. The unsecured interbank money market rate EONIA temporarily fell to as low as -0.085%, while the secured STOXX GC Pooling Overnight rate even went down to -0.177%. Although these very short-term rates have recently gone back up in line with developments in the liquidity situation, they remain firmly in negative territory. The three-month EURIBOR, by contrast, currently stands at a record low of 0.051%. This is likely to reflect the expectations of an increase in excess liquidity in the next few months as a result of the decision taken by the ECB Governing Council at the end of January to launch an expanded asset purchase programme. Overall, it is clear that, even when they are in negative territory, short-term money market rates react as expected to liquidity developments and move towards the interest rate on the deposit facility as excess liquidity rises.

Monetary developments in the euro area

Moderate rise in M3 against backdrop of continued sluggish economic activity

Last year saw a marked recovery in the growth of the broad monetary aggregate M3 despite sluggish economic activity, weak inflation dynamics and, latterly, a significant depreciation of the euro. At an (annualised) three-month rate of 4.6%, inflows to M3 in the final quarter reached a level typical of the first half of the last decade. This pick-up was due, above all, to the money-holding sector's sustained preference for highly liquid assets as interest rates continued to fall. In terms of counterparts, the growth in M3 was relatively broad-based; credit to the private sector, in particular, made a positive contribution again for the first

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

Changes in € billion, seasonally adjusted

Assets	2014 Q4	2014 Q3
Credit to private non-MFIs in the euro area	16.8	– 18.9
Loans	18.8	– 10.5
Loans, adjusted 1	28.4	– 10.8
Securities	– 2.0	– 8.4
Credit to general government in the euro area	38.3	41.1
Loans	13.0	– 1.4
Securities	25.2	42.5
Net external assets	30.0	27.9
Other counterparts of M3	– 56.0	33.8

Liabilities	2014 Q4	2014 Q3
Central government deposits	8.6	– 20.9
Monetary aggregate M3	114.2	107.4
of which Components		
Currency in circulation and overnight deposits (M1)	138.9	125.8
Other shorter-term bank deposits (M2-M1)	– 60.9	– 21.9
Marketable instruments (M3-M2)	36.3	3.6
Monetary capital	– 84.1	– 3.0
of which		
Capital and reserves	3.8	51.5
Other longer-term financial liabilities	– 88.0	– 54.5

***** Adjusted for statistical changes. **1** Adjusted for loan sales and securitisation.
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time in just under two years. In addition to moderate growth in real economic activity, the extremely expansionary monetary policy stance in the euro area is also likely to have caused lending to the private sector to continue its upward trajectory across all sectors.

Significant M3 growth still driven by overnight deposits

In the final quarter, the inflows to M3, which were already significant in the previous quarter, recorded a further rise. The increase was once again primarily driven by overnight deposits, which benefited from a further reduction in interest rates for other deposits and which were accumulated by households in particular as well as to a lesser extent by non-financial corporations. By contrast, these sectors' demand for short-term time deposits and savings deposits fell again significantly in the reporting quarter. Furthermore, M3 growth was distributed much more evenly across the euro-area countries than during the crisis years 2011 and 2012.

Continued upward trend in monetary and credit growth

Against this backdrop, the upward trend in monetary growth that has been observed since the beginning of 2014 gained further momentum in the reporting quarter and the annual growth rate of M3 rose markedly to 3.6%. The continuation of the upward trend also led to an increase in the annual growth rate for loans to the euro-area private sector (adjusted for loan sales and securitisation), which, at 0.1%, moved into positive territory again for the first time since July 2012. Because growth in lending business is still very moderate, despite evident signs of recovery, the underlying monetary dynamics in the euro area remain subdued.

Ongoing recovery in loans to non-financial corporations

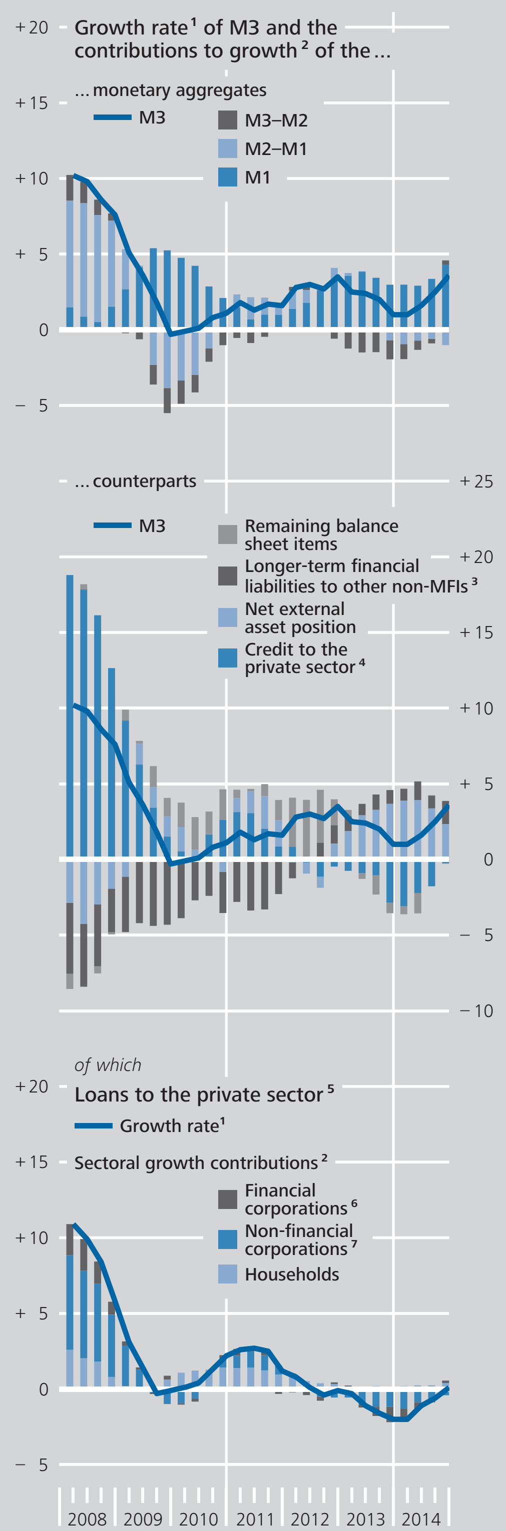
One particularly encouraging sign is that the upward movement in lending was again strongly supported by loans to non-financial corporations. During the reporting quarter, these borrowers recorded a net increase for the first time since summer 2011 (see chart on page 31). Another striking development was the pick-up in loans with a maturity of more than five years, which are usually used for investment purposes, and which had been in decline for a prolonged period. The annual rate of change for loans to non-financial corporations in the euro area therefore bottomed out at -3.1% in the first quarter of 2014; in the reporting quarter, it stood at -1.0%.

BLS, too, points to gradual stabilisation in lending to non-financial corporations

The Bank Lending Survey (BLS) carried out in the fourth quarter also pointed to a gradual upward movement in lending to the non-financial corporations sector. The euro-area institutions surveyed as part of the BLS reported a marked increase in demand for bank loans among non-financial corporations for the first time in over three years. The survey identified

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** Denoted with a negative sign because, taken in isolation, an increase curbs M3 growth. **4** Adjusted for loan sales and securitisation. **5** Adjusted for loan sales and securitisation from 2010 Q1. **6** Non-monetary financial corporations. **7** Non-financial corporations.

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an increase in the financing needs of large corporations, in particular. Demand for credit was bolstered by the continuing fall in lending rates. The banks surveyed in the BLS also said that, on balance, they had substantially eased their credit standards for loans to enterprises for the first time since 2007. This applied to enterprises of all sizes in a similar way. According to the information provided by the institutions, alongside banks' good liquidity position, the easing of standards was due, in particular, to the high level of competition in the area of corporate banking.

Recovery in lending to enterprises supported by all four large euro-area countries

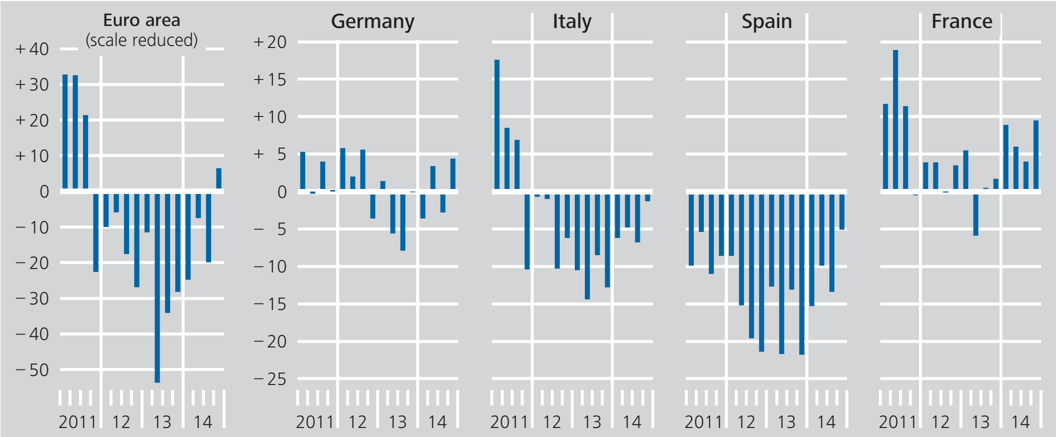
Support for the recovery in lending came from a broad base of countries. In the reporting quarter, this included the four large euro-area countries, in particular. In Germany and France, the quarterly inflows rose markedly in the fourth quarter. At the same time, the level of net redemptions fell in Spain and Italy. As in the previous quarters, enterprises' demand for bank loans is likely to have been dampened by an increase in the use of alternative sources of funding. Larger non-financial corporations obtain part of their funding directly from the capital market; furthermore, own funds represent the primary source of financing in Germany, in particular.

Perceptible increase in loans to households

The recovery in loans to households observed since summer 2013, too, persisted on balance. However, with an annual growth rate of 0.8% in the reporting quarter, the growth of this aggregate is to be regarded as moderate. In an environment characterised by historically low interest rates, growth was again driven by loans for house purchase. Unlike loans to non-financial corporations, the increase in the euro-area aggregate was supported only by some of the member states. Whereas loans for house purchase moved up significantly in most of the core countries of European monetary union, the extent of the reduction in the periphery countries remained essentially unchanged, not least against the backdrop of the persistent need for household deleveraging. For the euro area as a whole, the banks surveyed as part of

Loans to non-financial corporations

€ billion; three-month changes at the end of the quarter, seasonally adjusted and adjusted for loan sales and securitisation



Source: ECB.
Deutsche Bundesbank

the BLS, too, reported that demand in this credit segment had again risen considerably, while standards for loans to households for house purchase had been eased marginally.

The gradual upward movement in consumer credit observed in the last few quarters reflects the somewhat improved underlying dynamic of household consumption since 2013. This assessment is also consistent with what the institutions surveyed as part of the BLS reported, indicating that the perceptible increase in the consumer credit segment was accompanied by a marginal easing of standards.

Again only slight increase in net external asset position

Besides the net increase in loans to the private sector, monetary growth in the reporting quarter was again supported by an inflow of funds from abroad. However, as in the preceding quarter, the net external asset position of the MFI sector, which has been the main counterpart supporting M3 for the last two years, in the three months up to December recorded only a slight rise on balance. In December, perceptible net outflows could even be observed. Outflows from portfolio transactions with non-residents are likely to be the main reason for the waning momentum, while current account surpluses remained largely constant. This suggests that the decline in the preference of foreign investors for euro-area debt securities was further dampened by the renewed escalation of the situation in Greece, among other things. In addition, the demand of euro-area investors for foreign securities increased, too.

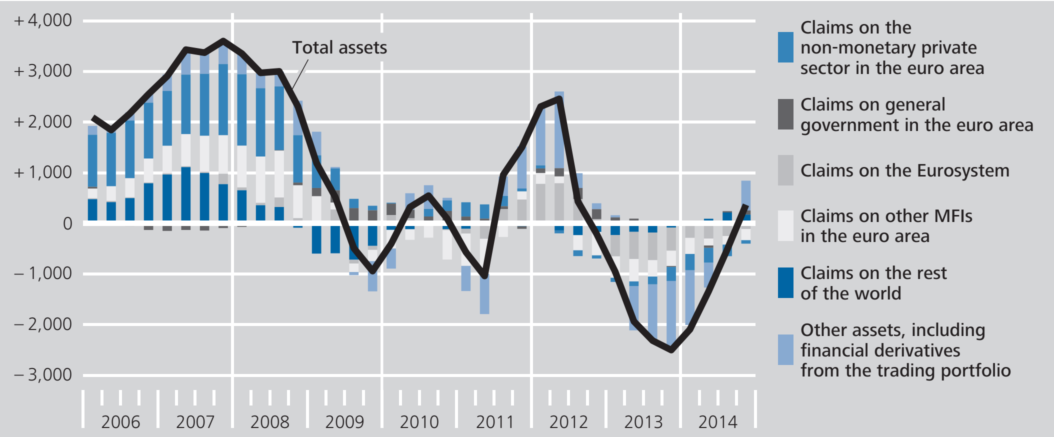
Major decline in monetary capital owing to long-term bank debt securities

The greatest supporting effect on the monetary aggregate in the reporting quarter was exerted by monetary capital, which, following continued outflows in the preceding quarters, again recorded a major decline in the fourth quarter. This was chiefly attributable to considerable net redemptions of bank debt securities with a maturity of over two years; unlike in the previous quarter, these were not counterbalanced by an extensive increase in capital and reserves.

The reduction of long-term bank debt securities in the hands of the euro-area money-holding sector has been observed since the fourth quarter of 2011. While net redemptions of these securities were initially attributable, above all, to weak investor demand, the refinancing situation of banks in the market has clearly improved again in the meantime. This was also reflected in the results of the banks surveyed as part of the BLS, which, as in the previous quarters, in the fourth quarter again reported distinct improvements in the issuance of longer-term bank debt securities. Hence, the recent net redemptions are likely to have in-

Balance sheet assets of euro-area banks*

12-month changes[1] at the end of the quarter, in € billion



Source: ECB. * Including money market funds. **1** Adjusted for statistical changes.
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creasingly been triggered by supply-side factors. First, the deleveraging initiated by the new regulatory provisions and the ECB's extensive asset quality review at the end of 2013 resulted in an overall decline in the funding requirements of the banking sector. Second, the demand for credit of the non-financial private sector in the periphery countries remains weak, which at present still means that banks require less funding. Moreover, despite improved market access, the continued reduction in long-term bank debt securities suggests that this type of refinancing has become less attractive compared with alternative sources of funding, such as the ever growing holdings of deposits and the liquidity provided by the Eurosystem at favourable conditions. Alongside lending to enterprises, the banks participating in the BLS explicitly stated substitution of alternative sources of funding as the reason for taking up the funds provided as part of the Eurosystem's TLTRO.

Increase in banks' asset items for the first time since the end of 2012

A look at euro-area banks' asset items shows that the balance sheet reduction in the banking sector, which began in mid-2012, came to an initial halt last year (see the chart above). In 2014, asset items increased again for the first time since the end of 2012, the growth being broadly based across the individual balance sheet items. In the reporting year, bank funds flowed mainly into financial derivatives in the trading portfolio; in addition, claims on non-residents were significant, too. The four large euro-area countries exhibited two divergent developments. Whereas banks in Germany and France decisively supported the balance-sheet leveraging seen in the euro-area aggregate, the pace of deleveraging merely slowed for banks in Spain and Italy. It was, above all, financial derivatives as well as bonds of other euro-area countries which were purchased in the latter two countries; in addition, the decline in claims on the private sector lost momentum.

German banks' deposit and lending business with domestic customers

Deposit business still marked by shifts

German banks' deposit business with domestic customers in the fourth quarter of 2014 was characterised by an, albeit discernibly weakened, rise in overnight deposits, while all other deposit types declined on balance. This development reflects the money-holding sector's continued strong preference for liquidity, which had been encouraged by even lower opportunity costs associated with holding money in the short term. Furthermore, the flat yield curve caused the decline in long-term time deposits, which had already been observed for several quarters, to significantly accelerate again in the reporting quarter. Possible reasons for the overall weak growth in deposit business are the search for more profitable forms of investment and the increase in the propensity to spend due to low interest rates.

Renewed increase in overnight deposits owing to low opportunity costs

A larger part of the inflow of short-term deposits continued to originate from households, which again markedly built up their cash holdings, although this increase was somewhat weaker that in the preceding quarter. At the same time, households' investment behaviour was characterised by a discernible reduction in other short-term deposits (time and savings deposits). Given the persistently stable income and financial assets situation of households in Germany, the weakened deposit growth may be a reflection of the higher propensity of this sector to purchase and invest. This assessment is consistent with different indicators on consumer climate and with the latest results of the BLS, which point to good consumer sentiment on the whole in the reporting quarter.

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

Changes in € billion, seasonally adjusted

Item	2014 Q3	2014 Q4
Deposits of domestic non-MFIs[1]		
Overnight	34.6	24.9
With agreed maturities		
of up to 2 years	− 5.1	− 3.0
of over 2 years	− 4.3	− 15.1
Redeemable at notice		
of up to 3 months	1.4	− 1.6
of over 3 months	2.3	− 1.3
Lending		
to domestic general government		
Loans	− 4.3	− 2.3
Securitised lending	5.4	− 5.3
to domestic enterprises and households		
Loans[2]	5.5	7.8
of which to households[3]	5.3	5.4
to non-financial corporations[4]	− 3.2	1.5
Securitised lending	4.2	0.3

***** 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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Further interest-related reduction in long-term deposits

Moreover, domestic banks' deposit business was characterised by a distinct reduction in long-term time deposits in the quarter under review and, as in the preceding quarters, the most pronounced movements were recorded by financial corporations. As in the previous quarters, financial corporations are likely to have shifted the freed-up funds into less liquid and riskier assets outside M3 instruments (such as debt securities and investment fund shares) in search of higher yield.

Positive lending business with non-banks

The considerable expansion 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 fourth quarter of 2014. This was essentially due to a material decrease in credit to general government. However, lending to the domestic non-bank sector developed positively overall as loans to households again recorded distinct inflows and unsecuritised loans to non-financial corporations increased slightly again following a noticeable decline in the previous quarter.

Considerable reduction in loans to general government

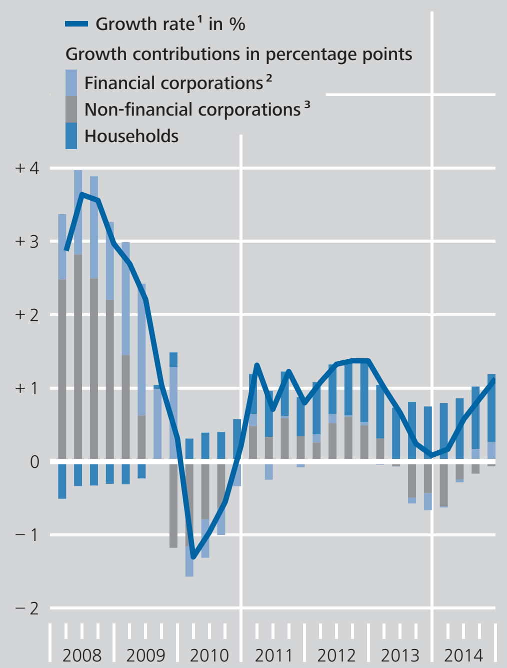
On the one hand, the considerable decline in lending to general government was the result of net redemptions of loans to general government, which had been recorded for several quarters and are likely to be connected to the consistently good budgetary position. However, the current decline was essentially attributable to the fact that banks significantly scaled back their holdings of domestic government bonds in the reporting quarter. The increase in net external assets of domestic banks suggests that this development may, in part, be linked to a greater interest of international investors in German government bonds.

Loans to households continue to be driven by loans for house purchase

As in the previous quarters, loans to households mainly consisted of loans for house purchase. Against the backdrop of the exceptionally favourable financing conditions and the lack of attractive alternative investment oppor-

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.
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tunities, loans for house purchase recorded another clear rise in the reporting period. Reasons for this are provided by the latest BLS results. For example, according to the banks participating in the BLS, the demand for private housing loans experienced renewed stimulation in the fourth quarter of 2014. The surveyed bank managers stated that the outlook on the housing market had clearly improved on the previous quarter from the point of view of borrowers and consumer confidence, too, contributed to the increase in demand. Conversely, when viewed in isolation, alternative sources of funding, such as household savings and loans from other banks, had a negative impact on household demand for loans for house purchase at the surveyed institutions. Simultaneously, the lending policies of banks were conducive to the rise in demand for loans for house purchase in the quarter under review. Although the banks surveyed as part of the BLS did not adjust their standards for housing loans in the final quarter, the margins for both average and riskier loans narrowed slightly.

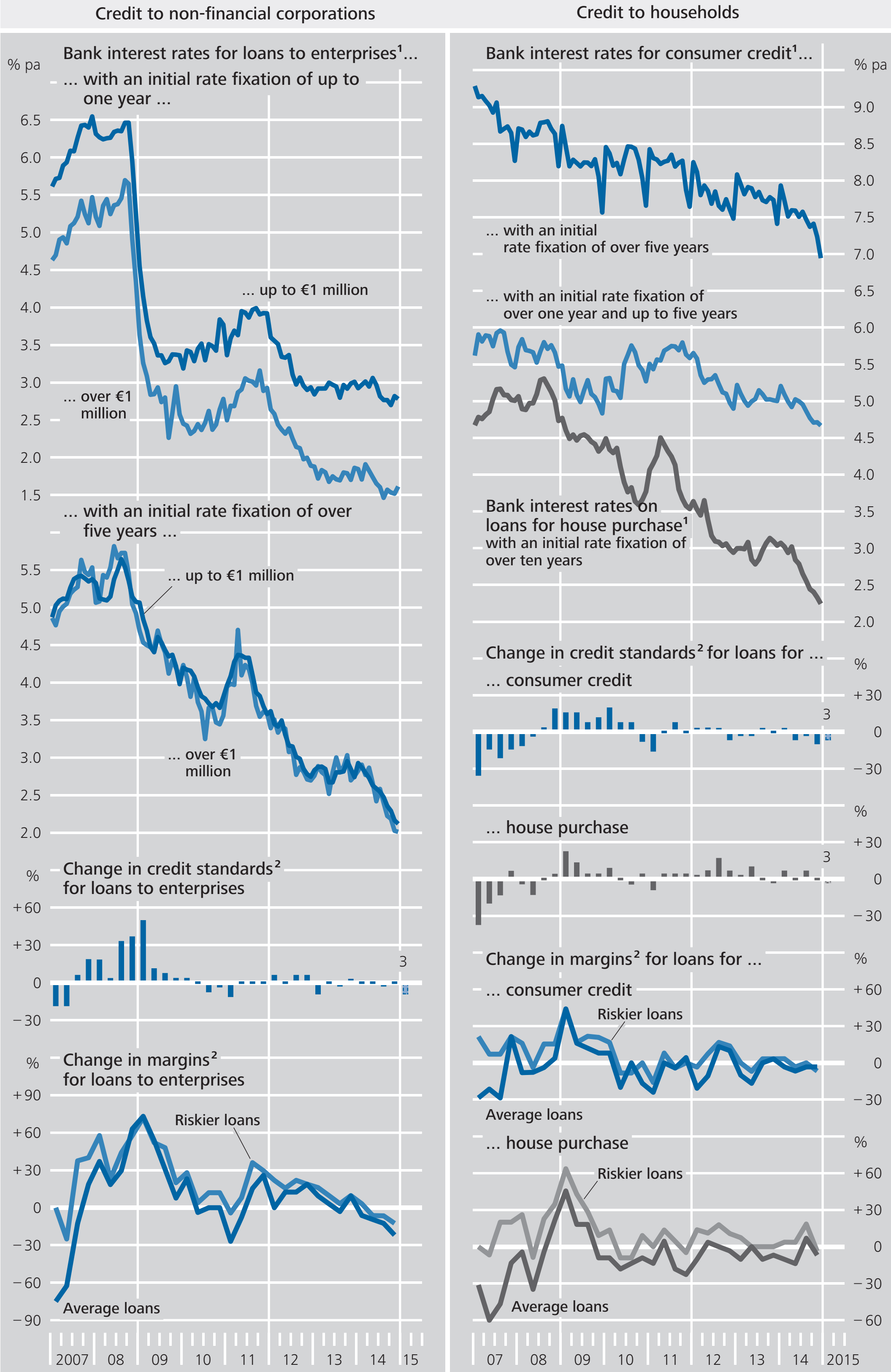
Net redemptions of consumer loans defy overall less strict lending policies

The banks surveyed as part of the BLS also experienced a significant increase in demand for consumer credit. However, in the aggregate across all reporting banks in Germany, net lending in this credit segment remained almost unchanged, which – given households' sound income and asset situation – could be attributable to a simultaneous rise in redemptions. According to the BLS, banks' lending policies in the final quarter were somewhat less strict overall than in the quarter before. First, the surveyed banks – above all, for competitive reasons – eased their credit standards somewhat; second, this segment, too, saw a slight narrowing of margins. On the whole, the increase in lending to households in Germany continues to be very moderate. The 12-month rate for loans to households edged up slightly from 1.4% in the previous quarter to 1.5%.

Slight increase in loans to non-financial corporations

Owing to a distinct upturn in November, loans to domestic non-financial corporations increased slightly on balance in the reporting quarter, having declined appreciably in the preceding quarter. Positive net lending to enterprises was marked by various developments in the individual maturity segments. Whereas the noticeably more expensive loans in the medium-term maturity segment fell substantially, shorter-term loans (with an agreed maturity of up to one year) and to a greater extent also long-term loans (with an agreed maturity of more than five years) exhibited discernible inflows on balance. The generally positive development in demand for corporate loans in the reporting quarter is likely to be attributable to the underlying trend of positive economic and business expectations and the historically favourable financing conditions. This assessment is largely consistent with the results of the BLS, which state that the positive demand for bank loans of non-financial corporations in the reporting quarter was driven by a heightened demand for funding for mergers, acquisitions and corporate restructuring as well as fixed invest-

Banking conditions in Germany



1 New business. According to harmonised euro-area 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 2015 Q1.

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ments and debt restructuring. Moreover, the bank managers taking part in the BLS indicated that, as in the previous quarters, demand of enterprises for bank loans, taken in isolation, was dampened by lower financing needs for inventories and working capital and the recourse to other sources of funding.

German banks' credit standards for enterprises eased

According to the results of the BLS, the lending policies of banks in the reporting quarter supported the positive development of loans to non-financial corporations. While credit standards on loans to non-financial corporations remained unchanged on balance, banks tightened margins on average loans considerably and on riskier loans markedly. In a departure from the preceding two quarters, these narrowed margins benefited not only large but also small and medium-sized enterprises. In addition to tightening margins, the institutions also eased the other surveyed credit conditions, such as collateral requirements, covenants and non-interest rate charges.

BLS indicates moderate interest of German banks in TLTROs

The BLS in the fourth quarter contained *ad hoc* questions on the banks' funding conditions, the impact of the new regulatory and supervisory activities and the banks' participation in the TLTROs from 2014 to 2016. In view of the current situation on the financial markets, German banks again reported that their funding situation had improved slightly compared with the preceding quarter. For the first time, the banks surveyed as part of the BLS did not, on balance, reduce their risk-weighted assets further in the second half of 2014 in response to the new regulatory and supervisory activities; nonetheless, they continued to scale back their riskier loans and strengthened their capital position. The TLTRO in December 2014 was met with moderate interest by the surveyed German institutions as the majority of banks did not face any funding shortages. The banks from the BLS sample that took part in the operation cited the attractive conditions as the reason for participating and said they wished to use the funds provided chiefly for lending. The institutions anticipate that taking part will improve their financial situation slightly, but do not expect any impact on their credit standards.

Bank lending rates follow interest rate decline in the capital market

Lending rates in the fourth quarter of 2014 largely followed the slight interest rate decline in the money and capital markets across all reported segments, maturities and volumes. Interest rates for long-term loans to enterprises decreased slightly and remained virtually unchanged on the whole for short-term loans. On average, at the end of December, the reporting institutions were charging interest of 2.8% for small-scale and 1.6% for large-scale short-term loans to domestic non-financial corporations. Interest rates for long-term loans to non-financial corporations stood at 2.1% and 2.0% of late, reaching a new all-time low since the introduction of the harmonised MFI interest rate statistics in 2003.

In the fourth quarter of 2014, the conditions on loans to households, too, fell to their lowest levels since 2003. At the end of December, the interest rate on long-term loans for house purchase dipped slightly to 2.2%. Deposits of households again earned less interest than in the previous quarter.