Monetary policy and banking business

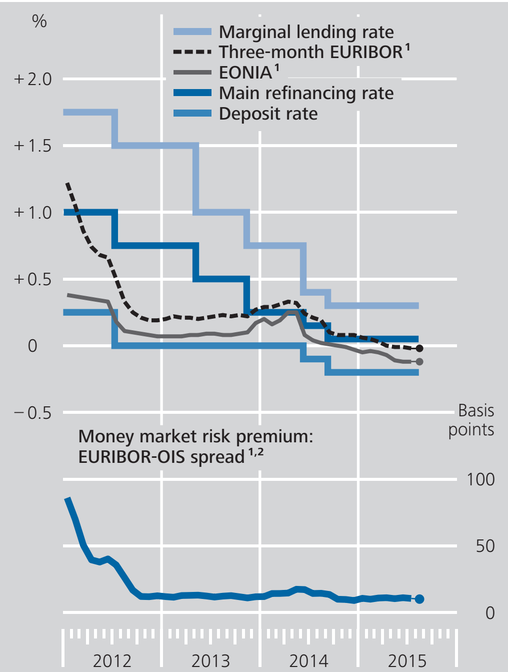
Monetary policy and money market developments

Key interest rates still at historical low

Based on its regular economic and monetary analyses, the ECB Governing Council decided to keep key interest rates unchanged in the reporting period. Therefore, the main refinancing rate remains at 0.05%, the marginal lending rate at 0.30% and the deposit rate at -0.20%. Moreover, the Eurosystem continued as planned to purchase bonds under the expanded asset purchase programme (EAPP) agreed in January 2015 and launched in March 2015.

The data that became available in the period under review were largely in line with the expectations of the ECB Governing Council, which therefore did not change its assessment of a broadening of the euro area's economic recovery and of a gradual increase in inflation rates over the coming years. The aim of implementing these monetary policy measures is to help to achieve a sustained return of inflation rates towards levels below, but close to, the target of 2% in the medium term, and to underpin the anchoring of medium to long-term inflation expectations. At its July meeting, the ECB Governing Council also announced that it would respond to a material change in the outlook for price stability by using all the instruments available within its mandate.

Money market interest rates in the euro area



Source: ECB. 1 Monthly averages. 2 Three-month EURIBOR less three-month EONIA swap rate. • Average 1 to 12 August 2015.

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Implementation of the EAPP

The purchases made as part of the EAPP mainly comprised public sector securities under the public sector purchase programme (PSPP). In addition, the third covered bond purchase programme (CBPP3) and the asset backed securities purchase programme (ABSPP) were continued on the same terms under the EAPP.

Purchase volumes remain consistent with announced target

By 7 August, the Eurosystem had purchased €259.7 billion worth of PSPP securities. The average residual maturity of the PSPP portfolio is currently just over eight years. The cumulated holdings under the CBPP3 and ABSPP amount to €106.6 billion and €10.6 billion. Overall, the volume of securities purchased under the EAPP thus equates to the average monthly volume of around €60 billion previously announced.[1]

128 banks borrow €73.8 billion in fourth TLTRO

On 18 June 2015, the fourth of eight targeted longer-term refinancing operations (TLTROs) was carried out, in which 128 institutions borrowed a total of €73.8 billion. This considerable demand is probably due first and foremost to the yield rise on the euro-area bond markets at the end of April and beginning of June, which spilled over to banks' longer-term mar-

1 Because market activity usually eases off in August, part of the planned purchase volume for this month was brought forward ("frontloaded") and, where necessary, subsequent purchases will be adjusted so that the target monthly volume of purchases under the EAPP will average €60 billion despite fewer purchases being made in August.

Liquidity development in the Greek banking system and central bank funding

The calling of early presidential and parliamentary elections in Greece between December 2014 and February 2015 triggered a huge loss of confidence in Greek banks on the part of depositors.

The ensuing months saw extensive outflows in the form of cash withdrawals and payment transfers abroad. Lacking other sources of funding, the banks financed these outflows primarily through increased borrowing from the Greek central bank (see the chart below). Accordingly, the share of loans issued by the Greek central bank – which include monetary policy refinancing operations and emergency liquidity assistance (ELA) – in the total liabilities of the Greek banks has grown from 11.3% at the end of November 2014 to 32.8%. By contrast, lending by all Eurosystem central banks to all euro-area banks made up a share of just 2.2% of their aggregate liabilities as at the end of June 2015.

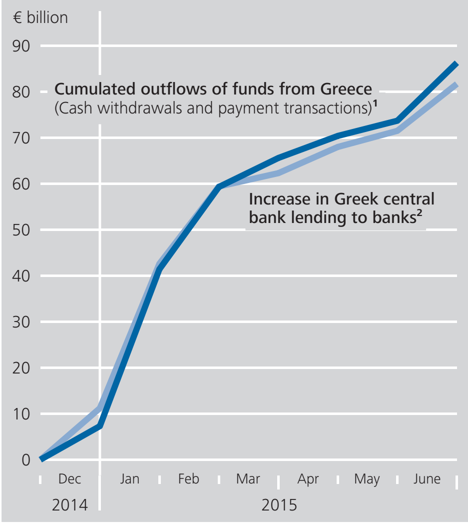
Unlike the implementation of monetary policy operations, ELA may be granted to solvent financial institutions facing temporary liquidity problems, provided the prohibition of monetary financing is observed, by Eurosystem national central banks – under their own responsibility and at their own risk and by way of exception.[1] Bearing this in mind, the development in Greece merits a critical assessment on several counts.

– The banks have repeatedly received liquidity assistance over several years and for protracted periods of time.[2] The granting of ELA, which actually is reserved for exceptional cases, has thus evolved from a means of providing temporary liquidity assistance to individual institutions into a longer-term source of funding for virtually the whole Greek banking system.

– The continuous use of ELA over a protracted period and the repeated need to recapitalise major parts of the Greek banking system may be seen as an indication that these were not merely temporary liquidity problems. This is also suggested by the current debate surrounding the substantial recapitalisation requirement of the Greek banking system as part of a new assistance programme.

Increase in Greek central bank lending to banks and outflows of funds from the Greek banking system

Cumulated change vis-à-vis end of November 2014



Source: Financial statements of the Bank of Greece. **1** Banknotes in circulation, including intra-Eurosystem liabilities related to the allocation of euro banknotes plus net liabilities related to transactions with the Eurosystem (TARGET2). **2** Lending to euro-area credit institutions related to monetary policy operations denominated in euro plus other claims on euro-area credit institutions denominated in euro.
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1 See also Deutsche Bundesbank, Monthly Report, November 2013, pp 23-27, and European Central Bank, Monthly Bulletin, 10th Anniversary of the ECB, 2008, pp 123-124.
2 At times, the liquidity assistance was replaced by monetary policy refinancing operations, made possible by temporary exceptions in the Eurosystem collateral framework and full allotment of the tendered amounts.

– The ELA funding should be viewed critically in the context of the prohibition of monetary financing.[3]

Given that neither the Greek government nor the Greek banks are able to tap any sizeable market funding sources, the continuous lending by these banks to the Greek government can ultimately only be maintained by the Greek central bank's ongoing granting of liquidity assistance. Seen from this perspective, the granting of ELA has the indirect effect of financing the Greek government.

The main responsibility for managing and resolving a solvency crisis lies with the governments concerned.[4] While the Eurosystem is obliged to support general economic policy in the EU as long as this does not jeopardise the objective of price stability, such support must remain proportionate and should not be a substitution for responsible actions on the part of economic policymakers. Otherwise, fiscal functions which are the responsibility of the government would be taken over, and funded, by the central bank.

The ECB Governing Council can object to the granting of ELA[5] by a national central bank if it finds, by a majority of two-thirds of the votes cast, that such operations interfere with the objectives and tasks of the Eurosystem.

3 The following is a summary analysis and is not meant to be exhaustive.
4 See European Central Bank, op cit, pp 123-124.
5 Or alternatively, as a more moderate option, restrict the granting of ELA.

ket-based financing conditions, making the current TLTRO more attractive. Although institutions' demand for the regular main refinancing operations and three-month tenders contracted, this did not fully offset the expansion in the refinancing volume through the TLTRO. The Eurosystem's total monetary policy refinancing volume amounted to just under €550 billion at the end of July, a level it last reached in February 2015.

Excess liquidity rising

As a result, excess liquidity rose further during the reporting period. While it only increased moderately between the beginning of May and the end of June, despite the ongoing EAPP purchases, owing to the simultaneous decline in the provision of liquidity in the regular refinancing operations, it rose significantly when the fourth TLTRO was allocated at the end of June. At almost €464 billion, excess liquidity is currently at the level it last reached in February 2013. An ongoing rise in excess liquidity, notwithstanding the dampening effect resulting from banks' weaker demand for liquidity in the regular refinancing operations, has been observed since the start of the PSPP purchases in March 2015. This situation is likely to become entrenched in the next few months.

Short-term money market rates firmly in negative territory

Short-term money market rates continued to decline slightly during the period under review against the backdrop of the rise in excess liquidity. The fall in the unsecured interbank money market rate (EONIA) and the secured overnight rate (Stoxx GC Pooling Overnight) slowed somewhat. The unsecured three-month EURIBOR also continued its downward trend to reach an all-time low of -0.02% at the current end. Overall, short-term money market rates therefore remained unaffected by the increase in yields and the higher volatility this caused on the euro-area bond markets. Temporary interest rate rises were only seen at the longer end of the money market forward curve and the swap curve for contractual maturities of more than one year. Developments in Greece had

Money market management and liquidity needs

The two reserve maintenance periods from 22 April to 21 July 2015 saw a marked increase in euro-area liquidity needs stemming from autonomous factors. In the June-July 2015 reserve period, the figure averaged €513.3 billion, which was €48.0 billion higher than its average level in the March-April 2015 period. This was due, first, to a net increase of €26.1 billion in government deposits with the Eurosystem and, second, to an overall increase of €26.8 billion in banknotes in circulation. By contrast, the remaining autonomous factors (including net foreign assets) had a counterbalancing effect. The changes in the autonomous factors in the period under review had a liquidity-providing effect of €4.9 billion on balance. Minimum reserve requirements rose by €1.7 billion to €112.3 billion across both reserve periods in June and July 2015. This increase triggered an additional rise in the calculated liquidity needs (see the table below).

The outstanding tender volume in the reporting period stood at €513 billion on average, although the greatest fluctuations occurred in the June-July 2015 reserve period (see the chart on page 27). This was the result of the fourth targeted longer-term refinancing operation (TLTRO) being conducted, during which a total of €73.8 billion was allotted. The outstanding volume from tender operations rose to an overall amount of €557 billion on 24 June 2015 – the value date of the fourth TLTRO. At the same time, in the week the operation was settled, there were, on balance, no major shifts from the main refinancing operation or the three-month tender which was also conducted. This is possibly attributable in part to the end of the month of June approaching. Prior to the two other month-ends, the familiar pattern of greater demand for the main refinancing operations and a simultaneous increase in the number of bidders was seen. On the whole, a gradual decline in the volume of main refinancing operations (of €96 billion in the first operation to a level of

Factors determining bank liquidity*

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

Item	2015 22 Apr to 9 June	2015 10 June to 21 July
I Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors		
1 Banknotes in circulation (increase: –)	– 11.5	– 15.3
2 Government deposits with the Eurosystem (increase: –)	– 6.3	– 19.8
3 Net foreign assets[1]	+ 29.8	– 12.8
4 Other factors[1]	– 29.4	+ 17.3
Total	– 17.4	– 30.6
II Monetary policy operations of the Eurosystem		
1 Open market operations		
(a) Main refinancing operations	– 23.0	– 13.5
(b) Longer-term refinancing operations	+ 20.5	+ 36.6
(c) Other operations	+ 92.5	+ 88.7
2 Standing facilities		
(a) Marginal lending facility	– 0.1	+ 0.2
(b) Deposit facility (increase: –)	– 31.1	– 3.4
Total	+ 58.8	+ 108.6
III Change in credit institutions' current accounts (I + II)	+ 41.6	+ 78.0
IV Change in the minimum reserve requirement (increase: –)	+ 0.2	– 1.9

* 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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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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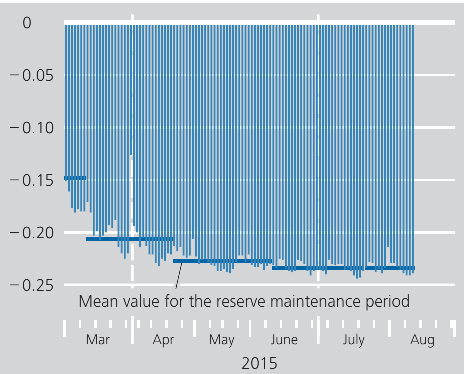
Spread between Stoxx GC Pooling Overnight and the main refinancing rate

Percentage points, daily data



Sources: ECB, Eurex Repo and Bundesbank calculations.
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around €75 billion in the last few weeks of the period under review) could be observed across the two reserve periods

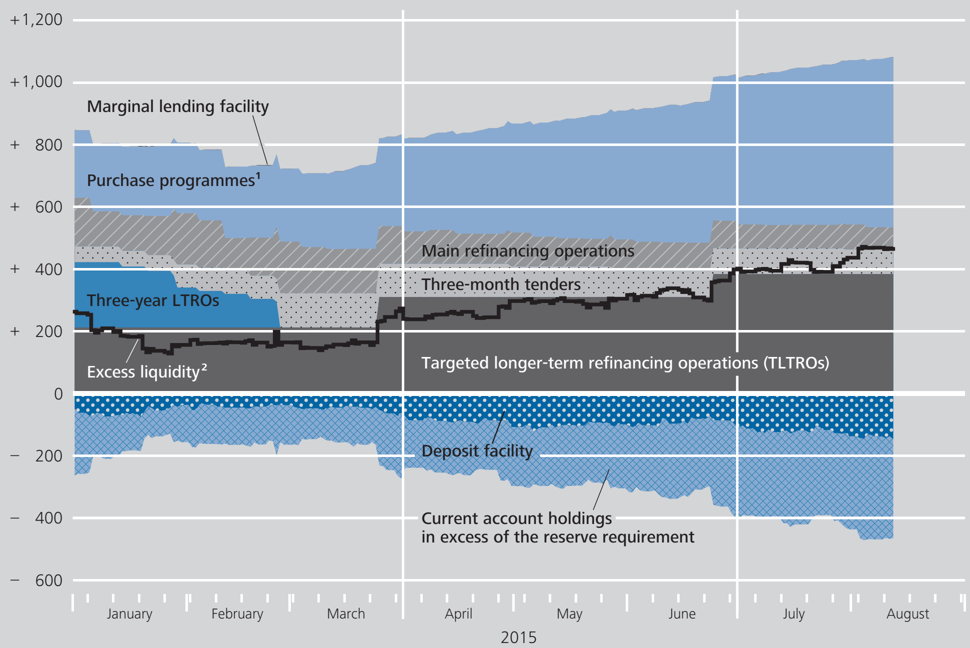
Purchases made as part of the expanded asset purchase programme (EAPP) had the greatest liquidity-providing effect in the reporting period. The balance sheet holdings of the three sub-programmes increased in the two reserve periods by €154.0 billion (PSPP), €29.9 billion (CBPP3) and €3.7 billion (ABSPP). As at 7 August 2015, balance sheet holdings amounted to €259.7 billion (PSPP), €106.6 billion (CBPP3) and €10.6 billion (ABSPP). The corresponding holdings in the purchase programmes of the Eurosystem which had already been discontinued further decreased in the period under review as a result of maturities and taking into account end-of-quarter revaluations. The balance sheet holdings of these programmes stood at €22.5 billion (CBPP1), €10.8 billion (CBPP2) and €130.6 billion (SMP) as at 7 August 2015. On 30 July 2015, the overall balance sheet volume of all outstanding purchase programmes exceeded the liquidity needs stemming from autonomous factors for the first time.

Overall, excess liquidity increased significantly in the two reserve periods under review, standing at an average of €293 billion in the period from April to June and at €372 billion in the June-July period after it had amounted to an average of only €220 billion in the reserve period from March to April 2015. Despite increasing, excess liquidity exhibited at times strong fluctuations within only a few days, which could often be attributed to the higher volatility of the autonomous factors (especially general government deposits with the Eurosystem). The liquidity needs resulting from the autonomous factors fluctuated between €459 billion and €548 billion in the reporting period.

Due to the very generous liquidity supply, overnight rates in the reporting period remained in line with the deposit facility rate of -0.20% and were consistently below the main refinancing rate of 0.05%. Excess liquidity, which is increasing on the whole, caused the gap to the key interest rate to widen further. This applied to both the EONIA as a reference rate for unsecured overnight deposits and for secured overnight money (GC Pooling Overnight, ECB basket) (see the charts opposite). The EONIA averaged -0.10% in the reserve period from April to June and -0.12% in the June-July period, compared with -0.06% in the period from March to April 2015. Secured overnight money showed similar developments. GC Pooling Overnight (ECB basket),

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), Asset-Backed Securities Purchase Programme (ABSPP) and Public Sector Purchase Programme (PSPP). **2** Current account holdings minus the minimum reserve requirement plus the deposit facility.

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which always fell short of the EONIA in the reporting period, stood at an average of -0.18% in the two periods under review (previous period: -0.16%), just two basis points higher than the deposit facility rate. New historical lows were reached at -0.143% for EONIA and -0.194% for GC Pooling Overnight (ECB basket). The increase in excess liquidity also led to an overall narrowing of the spread between the EONIA and the secured overnight rate. In addition, the increase in rates at month-end in the reporting period was a great deal less pronounced than in the previous months.

Another consequence of the increasingly comfortable liquidity situation was the considerably lower overnight turnover. The underlying EONIA turnover, which was already as low as €25.9 billion on average in the March-April 2015 reserve period, decreased further to stand at just €19.5 billion and €19.9 billion in the April-June and the June-July period respectively. A similarly strong decline of €5.3 billion on the previous period to an average of merely €8.9 billion in the reserve period from April to June 2015 was observed in overnight turnover with GC Pooling (ECB basket), which continued to fall in the subsequent period (June-July) to an average of €8.3 billion. Against the backdrop of excess liquidity increasing further and overnight rates approaching the deposit rate, overnight trading apparently became less attractive as a consequence.

Overall, excess liquidity continued to increase in the first two weeks of the July-September 2015 reserve period (€467 billion on 11 August). In addition to the continued provision of liquidity from the purchases made as part of the EAPP, a considerable decline in the autonomous factors contributed to the increase. The last day of July 2015, too, had only a marginal effect on overnight rates, whereas EONIA turnover, which had fallen to €12.3 billion that day (previous day: €19.6 billion), remained at this exceptionally low level for a few days after the turn of the month rather than returning to the level prior to month-end, as is often the case.

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

Changes in € billion, seasonally adjusted

Assets	2015 Q2	2015 Q1	Liabilities	2015 Q2	2015 Q1
Credit to private non-MFIs in the euro area	– 11.6	35.3	Central government deposits	– 22.5	22.4
Loans	3.9	46.4	Monetary aggregate M3	113.6	154.6
Loans, adjusted[1]	22.2	53.5	*of which* Components		
Debt securities	– 15.5	– 11.2	Currency in circulation and overnight deposits (M1)	175.8	214.6
Credit to general government in the euro area	59.9	38.5	Other shorter-term bank deposits (M2-M1)	– 32.2	– 58.4
Loans	– 15.4	21.6	Marketable instruments (M3-M2)	– 30.0	– 1.6
Debt securities	75.3	16.8	Longer-term financial liabilities to other non-MFIs	– 80.7	– 48.3
Net external assets	– 8.7	4.7	*of which* Capital and reserves	10.7	32.3
Other counterparts of M3	– 47.5	43.2	Other longer-term financial liabilities	– 91.5	– 80.6

* Adjusted for statistical changes and revaluations. The data shown have been extensively revised, mainly in connection with the new regulation concerning the balance sheet of the monetary financial institutions sector and changes to the statistical reporting framework of a number of national central banks. **1** Adjusted for loan sales and securitisation.

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just as little impact on short-term money market rates.

The positioning of money market rates within the interest rate corridor formed by the marginal lending facility and the deposit facility will therefore continue to be determined mainly by the (present and anticipated) liquidity position. Based on past experience of money market rate movements during periods of high excess liquidity and given the major alignment that has already been made towards the deposit facility rate, the potential for a further fall in secured and unsecured overnight rates is likely to remain fairly small, however, despite an expected further increase in excess liquidity.

Monetary developments in the euro area

Low interest rates and securities purchase programme key drivers of monetary growth

The marked recovery of the broad monetary aggregate M3 seen since the start of 2014 continued in the quarter under review. Although M3 growth was slightly weaker than in the previous quarter, the annual growth rate reached 5% at the end of June – its highest level since March 2009. This was due, above all, to the money-holding sector's sustained preference for highly liquid assets, driven by the exceptionally low interest rates. The low interest rate level was also one of the reasons behind the ongoing recovery in loans to the private sector, which benefited additionally from the modest yet broadly based cyclical upturn. Owing to the Eurosystem's securities purchases under the EAPP, monetary growth is also increasingly being underpinned by securitised lending to general government.

Significant M3 growth still driven by overnight deposits

Growth in M3 in the second quarter was again mainly driven by overnight deposits, which benefited from the comparatively small and decreasing differences in interest rates compared to other types of investment, and which were accumulated by households and non-financial corporations, in particular. Conversely, these sectors' demand for short-term time deposits fell again significantly in the reporting quarter. As in the two previous quarters, financial corporations also increased their overnight deposits, albeit to a lesser extent than the non-financial private sector. Ultimately, 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 slightly to 5.0% at the end of the period under review.

Upturn in lending growth continues

Despite a slightly slacker momentum in the second quarter, the ongoing recovery also marginally pushed up the annual growth rate for loans to the euro-area private sector (adjusted for loan sales and securitisation) to 0.9% at the end of June. Notwithstanding these evident signs of recovery, overall growth in lending to the private sector and thus the underlying monetary dynamics in the euro area remain very moderate, however.

Ongoing recovery in lending to non-financial corporations …

The ongoing recovery in lending also extended to loans to non-financial corporations, which recorded a rise for the third consecutive quarter and which increased appreciably between April and June (see chart opposite), albeit without quite matching the prior-quarter dynamic. This increase was once again driven mainly by loans with medium-term maturities, whereas long-term lending contracted. Furthermore, short-term lending, which increased slightly on balance, continued its upward trend. Given the strong cyclical bias of this maturity segment, a further upward movement may be expected in the wake of an ongoing economic upturn. The rebound in the annualised rate of change for loans to non-financial corporations in the euro area as a whole thus persisted and, at 0.1% at the end of the reporting quarter, moved marginally back into positive territory for the first time since May 2012.

… against the backdrop of rising demand

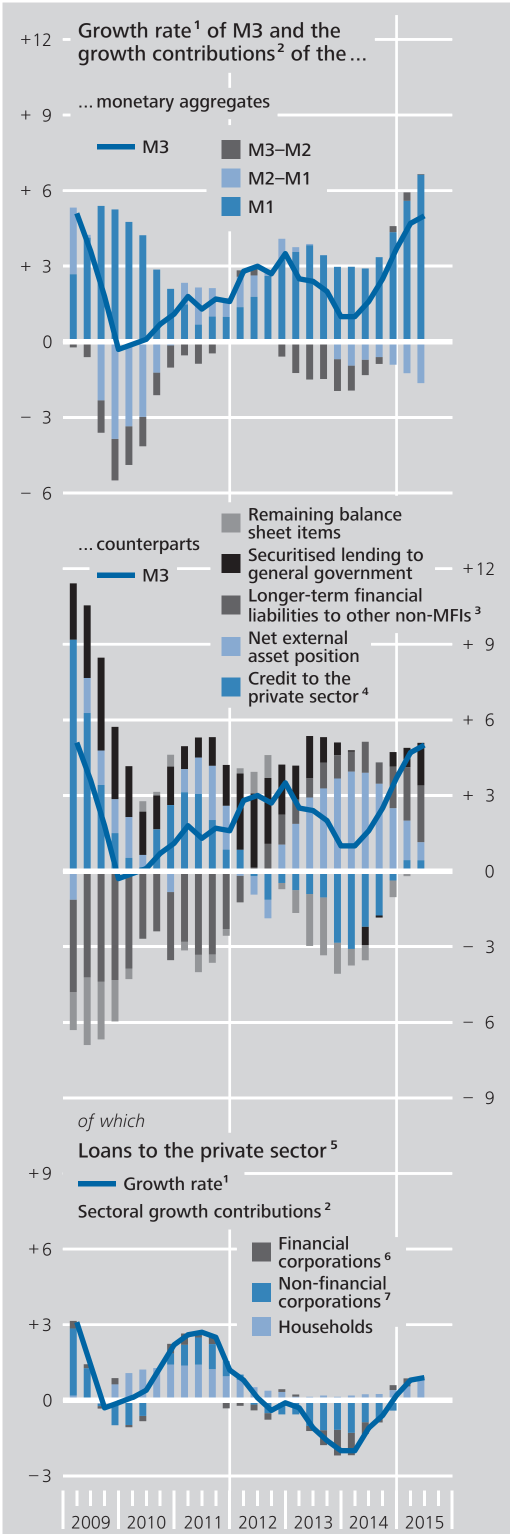
The Bank Lending Survey (BLS) carried out in the second quarter also pointed to a continued upward movement in lending to the non-financial corporations sector. Although the euro-area banks surveyed said they had, on balance, largely left standards for loans to enterprises unchanged at the first-quarter level, they reported a further perceptible increase in non-financial corporations' demand for bank credit. The banks stated that this was driven mainly by the low interest rates on business loans, which remained largely unaffected by the rise in yields observed in the capital market in the three months under review.

Corporate lending in big four euro-area countries less heterogeneous

While lending to euro-area non-financial corporations in the four largest euro-area countries had shown a highly heterogeneous pattern in the first quarter, developments in net

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, per se, 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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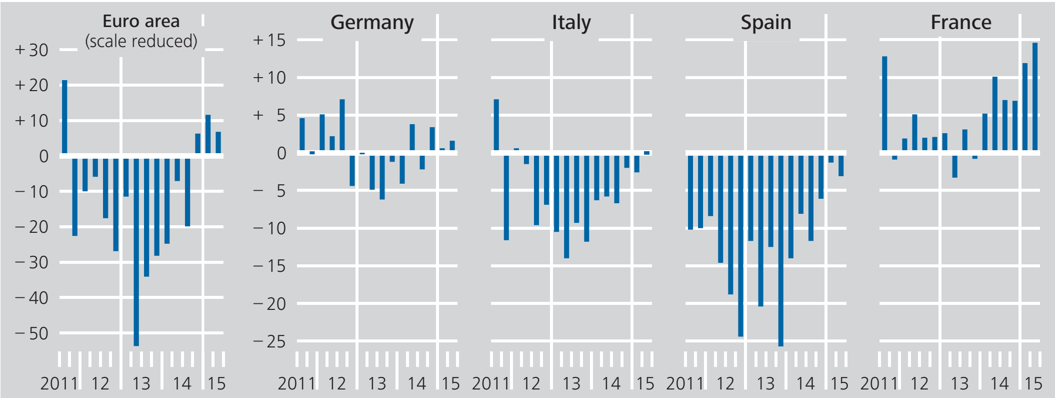
Loans to non-financial corporations*

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



Sources: ECB and Bundesbank calculations. * Non-financial corporations. As from the implementation of ESA 2010, from December 2014, holding companies of non-financial groups are no longer counted as belonging to the sector of non-financial corporations but are now allocated instead to the financial corporations sector in banks' monthly balance sheet statistics.
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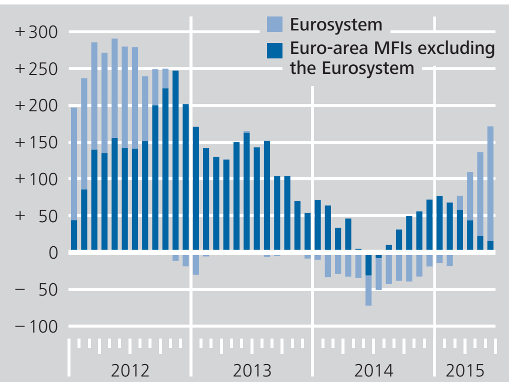
lending were somewhat more convergent in the three months under review. Banks in France and Germany recorded greater inflows, and there was almost a complete reduction of net redemptions in Italy.[2] Only Spain recorded a significant deterioration in loan dynamics, which was reflected by a more rapid reduction in lending, bringing the upward trend that had begun there in mid-2014 to an end. As in the preceding quarters, German and Italian firms' domestic demand for bank finance was probably curbed in part by their greater recourse to alternative sources of funding (see also page 34).

Securitised lending of MFIs to general government in the euro area

€ bn, end-of-month 12-month changes, not seasonally adjusted



Sources: ECB and Bundesbank calculations.
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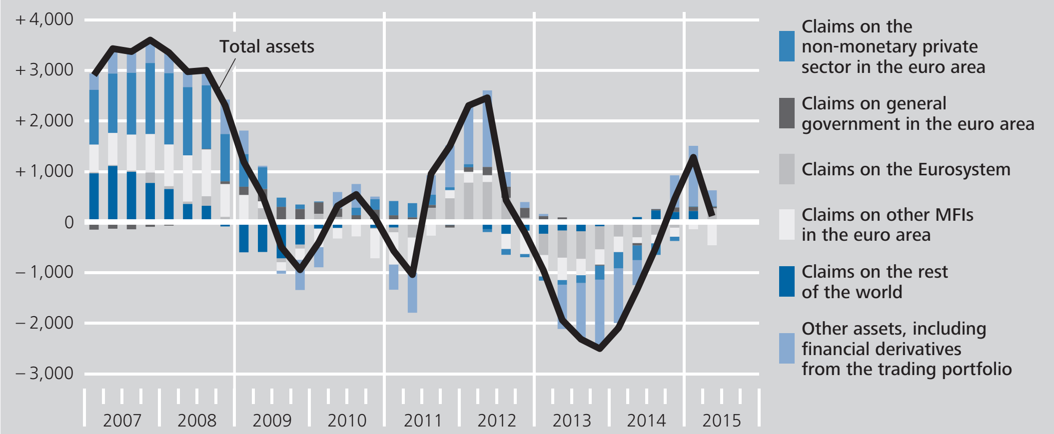
Marked rise in loans to households driven mainly by mortgages, …

Growth in lending to households accelerated significantly again in comparison to the previous quarter. However, at an annual growth rate of 1.7% between April and June, the expansion of this aggregate was still moderate. In an environment characterised by historically low interest rates, lending growth was again driven by loans for house purchase, although consumer credit also made a rising contribution. As in the previous quarters, euro-area aggregate growth in mortgage loans masked heterogeneous national developments. While mortgage lending continued to increase significantly, especially in Germany and France, the periphery countries saw a decline, not least on account of the need for household deleveraging in some of these countries, even though – except in Spain – there was a noticeable slowdown in net redemptions. For the euro area as a whole, the banks surveyed in the BLS likewise reported that demand in this credit segment had risen even more sharply than in the previous quarters, while credit standards had eased slightly.

2 In Germany, the lending business of domestic MFIs with domestic non-financial corporations was slightly negative during the quarter under review. However, because German banks expanded their lending to non-financial corporations in the rest of the euro area during the same period, Germany's contribution to the euro-area aggregate was positive overall.

Balance sheet assets of euro-area banks*

End-of-quarter 12-month changes[1] in € billion



Source: ECB. * Including money market funds. **1** Adjusted for statistical changes and revaluations.
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... but also increasingly by consumer credit

In contrast to loans for house purchases, the rise seen in consumer credit over the past few quarters was not limited to individual countries. It is probably a reflection of the ongoing pick-up in private consumption in the euro area. This is consistent with the information given by the institutions surveyed in the BLS, which reported a large increase in demand for consumer credit. According to the BLS, this was mainly attributable to consumers' high propensity to purchase, improved consumer confidence and the low interest rate level. Furthermore, the banks surveyed reported a slight easing of their credit standards in this segment.

Securitised lending to general government bolstering monetary growth

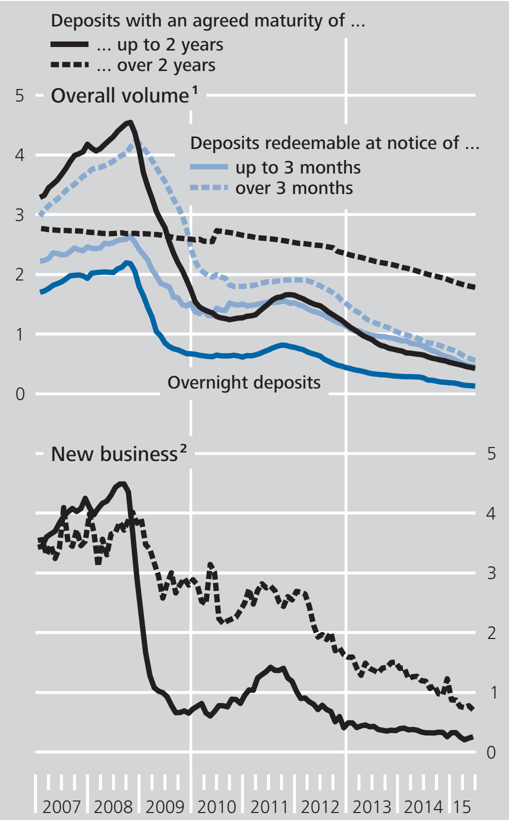
Monetary growth is also increasingly being supported by an expansion in securitised lending to general government (see the lower chart on page 30). This is likely to be chiefly a result of securities purchases by the Eurosystem under the EAPP. These increase the claims of the Eurosystem on general government, which, in turn, are counted as counterparts to the monetary aggregate. Given that purchases of securities from holdings of euro-area banks have no impact on the money stock, the rise in securitised lending to general government by the MFI sector as a whole indicates that much of the purchases ultimately originate from holders outside the domestic banking sector. This is consistent with the fact that the holdings of sovereign debt by banks and money market funds in the euro area fell only moderately in the second quarter.

Marked fall in monetary capital on the back of shrinking long-term bank debt securities

Another determinant of monetary growth in the quarter under review, besides lending to non-banks, was again provided by the change in other longer-term financial liabilities to other non-MFIs (monetary capital), which – despite a perceptible rise in capital and reserves in the wake of the new regulatory and supervisory activities – were reduced steeply again. This was primarily attributable to ongoing significant net redemptions of long-term bank debt securities with a maturity of over two years and marked withdrawals from long-term time deposits. In particular, the continued contraction of bank debt securities held by the money-holding sector is likely to be mainly due to supply-side factors in that, given banks' continuously growing deposits as well as cheap liquidity provided by the Eurosystem, market-based financing currently appears to be comparatively unattractive for banks. This is consistent with the fact that euro-area banks made ample use of the TLTRO carried out in June in view of rising bond market yields. Moreover, the banks responding to the March BLS reported that they intended to use the funds they procured under the EAPP not just for corporate lending but also, and primarily, as a substitute for alternative sources of funding.

Interest rates on bank deposits in Germany*

% pa, monthly



* Deposits of households and non-financial corporations. **1** According to the harmonised MFI interest rate statistics. Volume-weighted interest rates across sectors. Interest rate levels for overnight and savings deposits may also be interpreted as new business due to potential daily changes in interest rates. **2** According to the harmonised MFI interest rate statistics. Volume-weighted interest rates across sectors and maturities. Unlike the overall volume of contracts (ie deposit contracts on the balance sheet at the end of the month), the volume of new business (ie all contracts concluded in the course of a month) is explicitly recorded for time deposits only.

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First outflows in net external asset position since 2012

In the three months up to June, the MFI sector's net external asset position, which has been the main counterpart supporting M3 for the last two years, recorded net outflows for the first time since mid-2012 despite the euro area's sustained high current account surpluses.[3] This is presumably attributable to net capital exports in portfolio business fuelled by strong demand from domestic investors for securities issued outside the euro area. One fact behind this is likely to have been the substitution of domestic securities sold to the Eurosystem under the EAPP by foreign securities. Yet the expected scaling-down of government securities from the euro area by foreign investors under the purchase programme appears to have been rather limited to date. Furthermore, non-resident investors expanded their purchases of shares a little on balance.

Fall in banks' balance sheet assets

The balance sheet assets of euro-area banks contracted perceptibly in the second quarter of 2015, triggered mainly by a decline in interbank claims in the euro area, as well as a marked rundown of financial derivatives in the trading portfolio (see the chart on page 31). Banks in Germany and France, in particular, reduced their claims on other financial institutions (excluding the Eurosystem) distinctly, both domestically and in the rest of the euro area. This, too, is presumably due to the comfortable liquidity position of the financial institutions. The reduction in commercial banks' claims on general government in the euro area as a result of the EAPP had only a limited impact on their balance sheet assets. By contrast, banks' claims on the Eurosystem in the quarter under review showed a slight expansion, which was accordingly spread broadly across the euro-area countries.

German banks' deposit and lending business with domestic customers

Deposit business still marked by portfolio shifts

In Germany, too, the investment behaviour of non-banks in the second quarter of 2015 – as in the preceding quarters – was characterised by growth in short-term deposits and a reduction in longer-term deposits. Investors' marked preference for liquidity is primarily due to the current interest rate environment (see the chart on this page). Thus the further narrowing of the interest rate spread of savings and short-term time deposits over overnight deposits was a key factor prompting non-financial corporations and, in particular, households to switch to liquid deposits. The growth in overnight de-

3 The net external asset position for the first quarter was revised discernibly upwards after the May Monthly Report was published. The revised data now show a small net inflow for the first quarter.

posits in the quarter under review is likely to have been amplified by German households' substantially rising disposable incomes and the high liquidity position of German enterprises.

Investment behaviour of financial corporations mixed

The investment behaviour of financial corporations was likewise marked by shifts in the second quarter. While other financial intermediaries, much like the non-financial private sector, showed a preference for more liquid deposits and shifted the bulk of the funds freed by liquidating their long-term time deposits into overnight deposits, insurance corporations and pension funds also reduced their shorter-term deposits on balance. This is likely to have been driven by shifts into higher-yielding forms of investment outside M3.[4]

Net decline in lending business with non-banks, but …

Banks' lending business with the domestic non-bank sector contracted appreciably in the three months under review, after increasing in the previous seven quarters, in some cases significantly. This was essentially due to a considerable decrease in credit to general government, which affected both loans and securitised lending in equal measure. This is probably attributable to higher net redemptions of loans in the context of the ongoing buoyant position of public finances and also to securities purchases by the Eurosystem under the EAPP.

… lending business with private sector positive and …

Conversely, lending to the domestic private sector developed positively in the second quarter. However, lending growth was distinctly less dynamic than in the first quarter; this waning momentum was attributable almost exclusively to lower securitised lending. In contrast, the marked uplift in loans to the domestic private sector, adjusted for loan sales and securitisation, that had been observed in the first three months continued in the second quarter.

… driven by private loans for house purchase

In sectoral terms, loans were again primarily granted to households, which is reflected in an increase in the corresponding annual growth rate from 1.8% in the first quarter to 2.1% at the end of June. As before, this growth was driven by loans for house purchase, which make up the lion's share of household borrowing, the annual growth rate of which reached 2.9% at the end of June – the highest level in around 12 years. Mortgage lending was fuelled by a steep rise in households' financial assets, their stable income situation and the continued exceptionally favourable financing conditions. The MFI interest rate statistics show that the interest rate on long-term mortgage loans stood at 1.9% at the end of the second quarter, after May's figure of 1.8% marked a new

Lending and deposits of monetary financial institutions in Germany*

Changes in € billion, seasonally adjusted

Item	2015 Q1	2015 Q2
Deposits of domestic non-MFIs[1]		
Overnight	45.4	48.9
With agreed maturities		
of up to 2 years	– 0.1	– 16.5
of over 2 years	– 9.9	– 14.3
Redeemable at notice		
of up to 3 months	– 2.2	3.3
of over 3 months	– 2.6	– 4.2
Lending		
to domestic general government		
Loans	11.3	– 6.3
Debt securities	2.2	– 6.5
to domestic enterprises and households		
Loans[2]	14.7	12.1
of which to households[3]	9.0	10.0
to non-financial corporations[4, 5]	3.3	– 0.8
Debt securities	6.9	– 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 and revaluations. **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. **5** As from the implementation of ESA 2010 in banks' balance sheet statistics, the holding companies of the non-financial corporations sector (eg management holding companies with predominantly financial shareholdings) have been reclassified from the non-financial corporations sector to the financial corporations sector (as other financial intermediaries). Moreover, those entities and enterprises which are non-market producers (eg municipal utilities) and have been counted as non-financial corporations thus far have now been reallocated to the general government sector (as off-budget entities).
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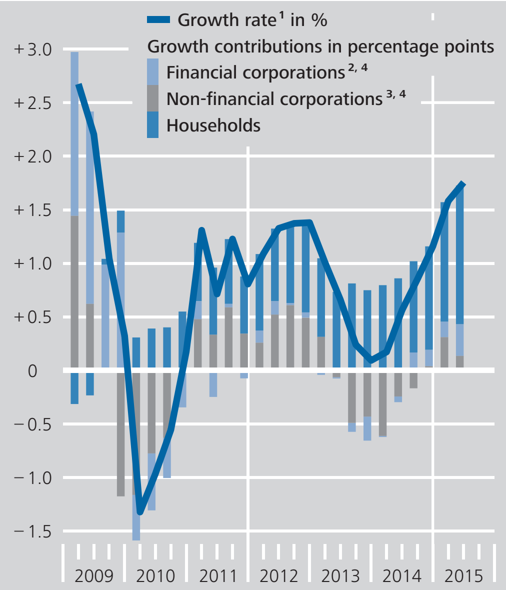
4 See Deutsche Bundesbank, Portfolio reallocations into higher-yielding assets in Germany, Monthly Report, May 2015, pp 39-41.

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. **4** As from the implementation of ESA 2010 in December 2014, holding companies of non-financial groups are no longer counted as belonging to the sector of non-financial corporations but are now allocated instead to the financial corporations sector.

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historical low since the harmonised MFI interest rate statistics were introduced. Other reasons for this are provided by the latest BLS results, which suggest that demand for credit in this segment was additionally supported by households' continuing positive outlook regarding the housing market and house price developments. The rising demand for loans for house purchase in the quarter under review was boosted by banks' lending policy. Although the banks participating in the BLS did not adjust their credit standards in this segment in the second quarter, they did narrow their margins on loans for house purchase, in some cases considerably.

Demand for consumer credit aided by positive setting

The banks surveyed in the BLS also experienced a significant increase in demand for consumer credit in the second quarter of 2015. The respondent institutions attributed this to consumers' increased propensity to purchase, buoyant consumer confidence and the low interest rate level. The banks' credit standards for consumer credit remained unchanged on balance between April and June according to the BLS. The BLS banks did, however, narrow their margins for both average and riskier loans in light of the current heightened competition in the banking sector.

Lending to non-financial corporations slightly negative, but …

By contrast, German banks' lending business with domestic non-financial corporations declined a little in the quarter under review, after recording a distinctly positive performance in the previous two quarters. However, this statement must be qualified by the fact that long-term loans, which firms habitually use to fund larger projects, again showed perceptible inflows. Hence the outflows stemmed from the much more volatile segment of short and medium-term lending.

… no indication of supply-side constraints, but rather …

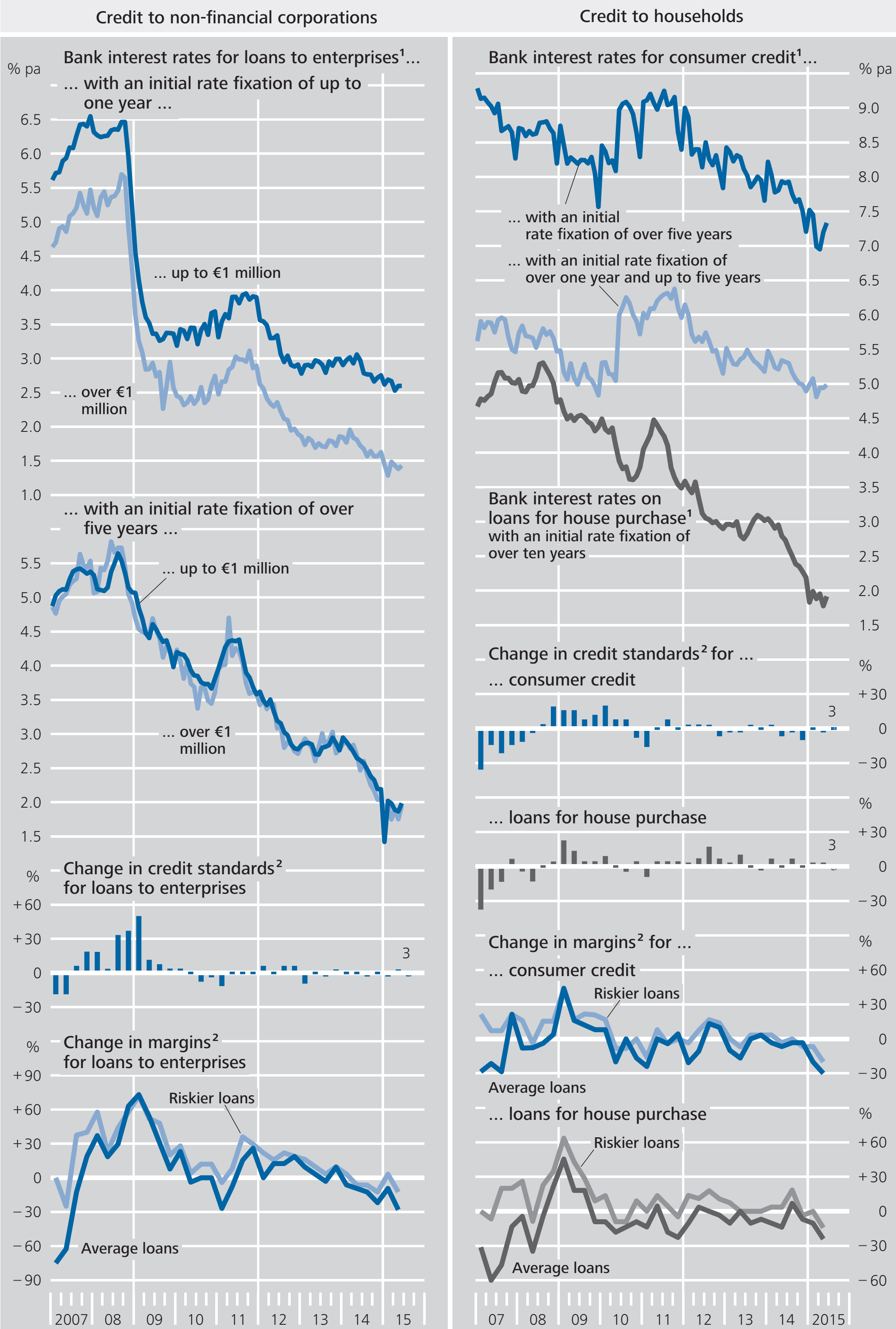
The BLS results provide no indication that the decline in loans to non-financial corporations could be due to supply-side reasons. The surveyed institutions markedly reduced their margins for both average and riskier loans and did not noticeably tighten their credit standards for business loans. Furthermore, they eased individual credit conditions (eg ancillary charges and loan covenants) for their borrowers.

… driven mainly by subdued demand

Hence, the weak credit dynamics seem to be due chiefly to a persistently sluggish demand for loans. According to the BLS responses, firms' borrowing needs were dampened above all by their abundant scope for internal financing. In fact, internal funds – which probably now exceed domestic firms' moderate level of investment – have expanded steadily in recent years on the back of German enterprises' stable profit and liquidity situation and have lessened their need for external funding.[5] Moreover,

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; Deutsche Bundesbank, Differences in dynamics of loans to non-financial corporations in Germany and France, Monthly Report, November 2014, pp 36-37; and Deutsche Bundesbank, An international comparison of the importance of bank credit as a debt financing instrument for non-financial corporations, Monthly Report, November 2014, pp 42-43.

Banking conditions in Germany



1 New business. According to the harmonised euro-area MFI interest rate statistics. Until May 2010, the aggregate interest rate was calculated as the average rate weighted by the reported volume of new business. As of June 2010, an interest rate weighted by the reported volume of new business is first calculated for each level. The aggregate interest rate is calculated by weighting the interest rates for the levels by the extrapolated volumes. 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 Q3.

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alternative external sources of funds – such as intra-group loans, trade credit and loans from shadow banks – have been gaining in importance for German businesses for some time, therefore additionally curtailing the share of bank loans in their funding portfolio. The BLS findings imply, on the other hand, that corporate borrowing was supported *per se* in the quarter under review by the low interest rate level and by funding requirements for refinancing, debt restructuring and renegotiation.

Interest rates for business loans still historically low

The BLS responses indicating that the current interest rate environment is conducive to lending are borne out by the finding in the interest rate statistics that interest rates on business loans are still at historically low levels. The interest rates on short-term funds, irrespective of loan size, were even somewhat lower at the end of June than in the preceding quarter, and interest rates on long-term small-volume loans remained stable at 2.0%. Only interest rates on large-volume loans with an interest rate lock-in period of over five years went up markedly to 1.9%. Past experience suggests, however, that interest rates in this credit segment are strongly driven by individual transactions and are therefore highly volatile. Overall, neither the interest rates on loans to enterprises nor those on retail mortgages shadowed the considerable fall and subsequent rebound in capital market yields in the first half of 2015 in this form.

TLTRO funds used chiefly for lending

The BLS conducted in the second quarter contained *ad hoc* questions on the banks' funding conditions, the impact of the new regulatory and supervisory activities (including the capital adequacy requirements defined in the CRR/CRD IV and the requirements resulting from the ECB's comprehensive assessment) and on the banks' participation in the TLTROs from 2014 to 2016. The German respondent banks once again reported that their funding situation had improved slightly compared with the preceding quarter as a result of the situation in the financial markets. The banks did not, on balance, reduce their risk-weighted assets further in the first half of 2015 in response to the new regulatory and supervisory activities, but instead significantly strengthened their capital position further. The TLTRO carried out in March 2015 met with similarly moderate interest from the surveyed German institutions as had been the case three months earlier. Those banks which did participate cited the attractive TLTRO terms as the reason for doing so. They stated their wish to use the funds obtained chiefly for granting loans, in accordance with the TLTRO's objective. The banks anticipate that taking part will improve their financial situation somewhat, but do not expect any effects on their credit standards.