Monetary policy and banking business

Monetary policy and money market developments

ECB Governing Council cuts key interest rates to new low

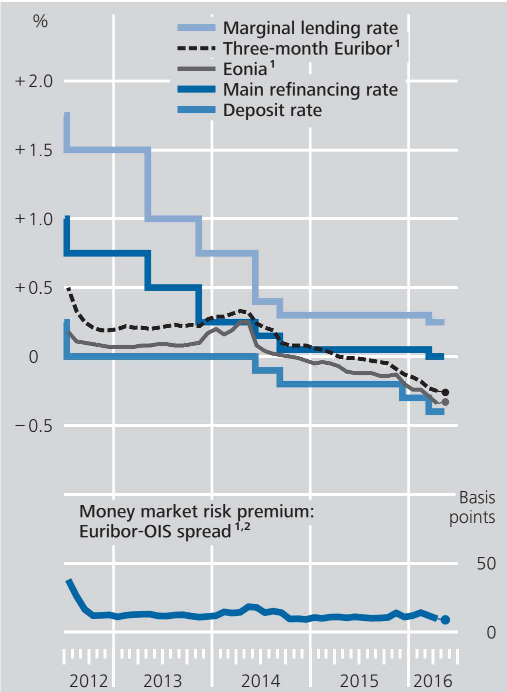
Based on its regular economic and monetary analyses and the latest Eurosystem staff projections, the ECB Governing Council adopted a further package of monetary policy measures at its meeting on 10 March 2016. It cut the rate on the deposit facility by 10 basis points (bp) to -0.40% and lowered the main refinancing rate and the interest rate of the marginal lending facility by 5 basis points each to 0% and 0.25% respectively. Furthermore, the Governing Council stated that, taking into account the current outlook for price stability, it expected the ECB's key interest rates to remain at present or lower levels for an extended period of time, and well past the horizon of its net asset purchases.

After reviewing the monetary policy stance as announced in January, the majority of the ECB Governing Council considered an extensive new package of measures necessary to counteract the increased risks to the ECB's price stability target and to avoid any second-round effects on wage and price setting. Annual inflation as measured by the Harmonised Index of Consumer Prices (HICP) fell from 0.3% in January 2016 to -0.2% in February, with all main HICP components contributing to this decline. In addition, the outlook for HICP inflation was revised downwards compared with the December Eurosystem staff macroeconomic projections, primarily reflecting the fall in oil prices over recent months. In this context, the package of monetary measures is intended to help further ease financing conditions, reinforce the momentum of the euro area's economic recovery and accelerate the return of inflation to levels below, but close to, 2%. At the same time, however, the ECB Governing Council noted that very low or negative inflation rates would be unavoidable over the next few months as a result of movements in oil prices, but that inflation rates are likely to pick up again later in 2016 and thereafter.

ECB Governing Council increases monthly purchases under the APP and …

Another component of the package of measures adopted by the Governing Council was an expansion of the volume of the monthly purchases under the expanded asset purchase programme (APP) by €20 billion to €80 billion as of April 2016. These purchases are intended to run until the end of March 2017 or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its aim of achieving inflation rates below, but close to, 2% over the medium term. To ensure the continued smooth implementation of the asset purchases, the issuer and issue share limits for the purchases of bonds issued by European institutions is to be increased from 33% to 50%. Moreover, the proportion of bonds issued by European insti-

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 May 2016.
Deutsche Bundesbank

Money market management and liquidity needs

The two reserve maintenance periods between 27 January 2016 and 26 April 2016 saw a marked increase in euro-area liquidity needs stemming from autonomous factors (see the table below). The liquidity requirement in the March-April 2016 reserve period averaged €687.1 billion, while fluctuating within a broad corridor between €611.8 billion and €726.8 billion over the period under review; this was €90.2 billion up on its average level in the December 2015-January 2016 reserve period. The main factor driving the stronger average demand for liquidity was the significant net rise of €64.9 billion in government deposits. Another driver was a decline in the combined total of net foreign assets and other factors – which are considered together because of liquidity-neutral valuation effects – by €28.8 billion overall, causing liquidity to be absorbed in the same amount. By contrast, the €3.5 billion net decline in banknotes in circulation expanded liquidity, as the usual seasonal fall in demand after Christmas exceeded the increase in the March-April period. The minimum reserve requirement rose across the two reserve periods by a total of €1.2 billion to €114.3 billion in March-April 2016, which had an absorbing effect.

Following the monetary policy decisions of 10 March 2016, the increase in the volume of monthly purchases under the expanded asset purchase programme (APP) implemented as of 1 April 2016 further raised the share of liquidity provision attributable to the securities purchase programmes. Thus the APP share in open market operations rose from an average of 63% in the January-March 2016 reserve maintenance period to 66% in the March-April 2016 maintenance period (68% as of 6 May 2016), see the chart on page 27. The aggregate balance sheet holdings of securities were boosted to an average value of €1,000.1 billion in the March-April 2016 reserve maintenance

Factors determining bank liquidity*

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

Item	2016 27 January to 15 March	2016 16 March to 26 April
I Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors		
1 Banknotes in circulation (increase: –)	+ 9.4	– 5.9
2 Government deposits with the Eurosystem (increase: –)	– 33.1	– 31.8
3 Net foreign assets[1]	– 3.8	+ 19.5
4 Other factors[1]	– 20.7	– 23.8
Total	– 48.2	– 42.0
II Monetary policy operations of the Eurosystem		
1 Open market operations		
(a) Main refinancing operations	– 8.7	– 4.8
(b) Longer-term refinancing operations	– 5.2	– 0.9
(c) Other operations	+ 95.8	+ 92.5
2 Standing facilities		
(a) Marginal lending facility	– 0.1	+ 0.1
(b) Deposit facility (increase: –)	– 33.9	– 31.5
Total	+ 47.9	+ 55.4
III Change in credit institutions' current accounts (I + II)	– 0.6	+ 13.5
IV Change in the minimum reserve requirement (increase: –)	– 0.5	– 0.7

* 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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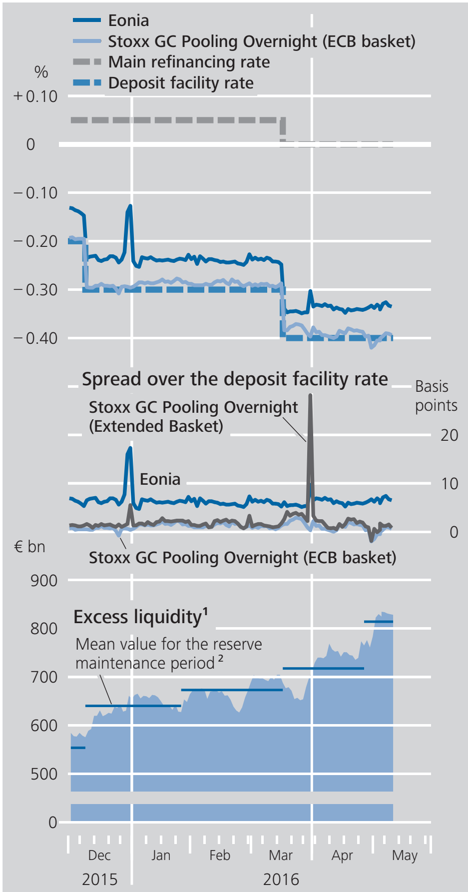
period, the bulk of which (€666 billion) was attributable to the public sector purchase programme (PSPP) launched in March 2015. During the course of the two reserve maintenance periods under review, the balance sheet holdings of the three APP components climbed by €177.5 billion (PSPP), €21.7 billion (CBPP3) and €2.7 billion (ABSPP). As at 29 April 2016, these holdings stood at €726.5 billion (PSPP), €172.3 billion (CBPP3) and €19.0 billion (ABSPP). On the other hand, maturities and end-of-quarter revaluations continued to diminish the balance sheet holdings of securities accumulated under the now terminated Eurosystem asset purchase programmes. On 29 April 2016 these stood at €19.1 billion under the CBPP1 (-€1.0 billion compared with 27 January 2016), €8.5 billion under the CBPP2 (-€0.8 billion) and €114.7 billion under the SMP (-€8.3 billion).

By contrast, the outstanding tender volume barely changed during the period under consideration (see the chart on page 26), notwithstanding the lowering of the main refinancing rate to a low of 0.00%. The tender volume declined by around €6 billion vis-à-vis the January-March 2016 period to €519 billion on average in March-April 2016. This decline was due in part to the low take-up of €7.3 billion in the seventh targeted longer-term refinancing operation (TLTRO) at the end of March 2016. The overall volume allotted under the TLTROs consequently rose to only around €425 billion. In contrast to this, the funding volume resulting from the three-month tenders declined further by €14 billion to €38 billion compared with the average of the December 2015-January 2016 period. Demand for main refinancing operations in the two reserve maintenance periods under review hovered between €54.0 billion and €69.0 billion and was thus down on the previous period under consideration (between €60.5 billion and €89.0 billion).

On balance, the liquidity surplus increased by €78 billion to €718 billion on average in the March-April 2016 period compared with the average level during December 2015-January 2016. Excess liquidity was sporadically subject to heightened volatility lasting for a few days, primarily as a result of swings in the autonomous factors (notably government deposits with the Eurosystem).

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. **2** The last period displayed is still ongoing.
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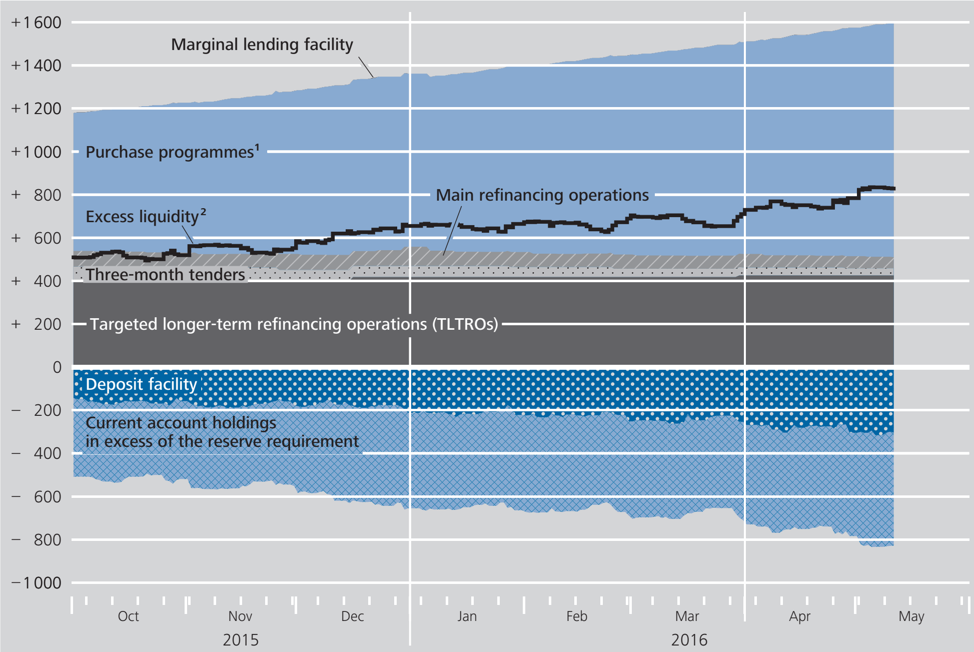
The extremely abundant liquidity supply meant that overnight rates in the period under observation continued to move in line with the deposit facility rate, so that the reduction in the latter on 16 March 2016 to -0.40% had a direct impact on the market (see the chart above). Eonia averaged -0.34% in the March-April 2016 maintenance period, ie 6 basis points above the de-

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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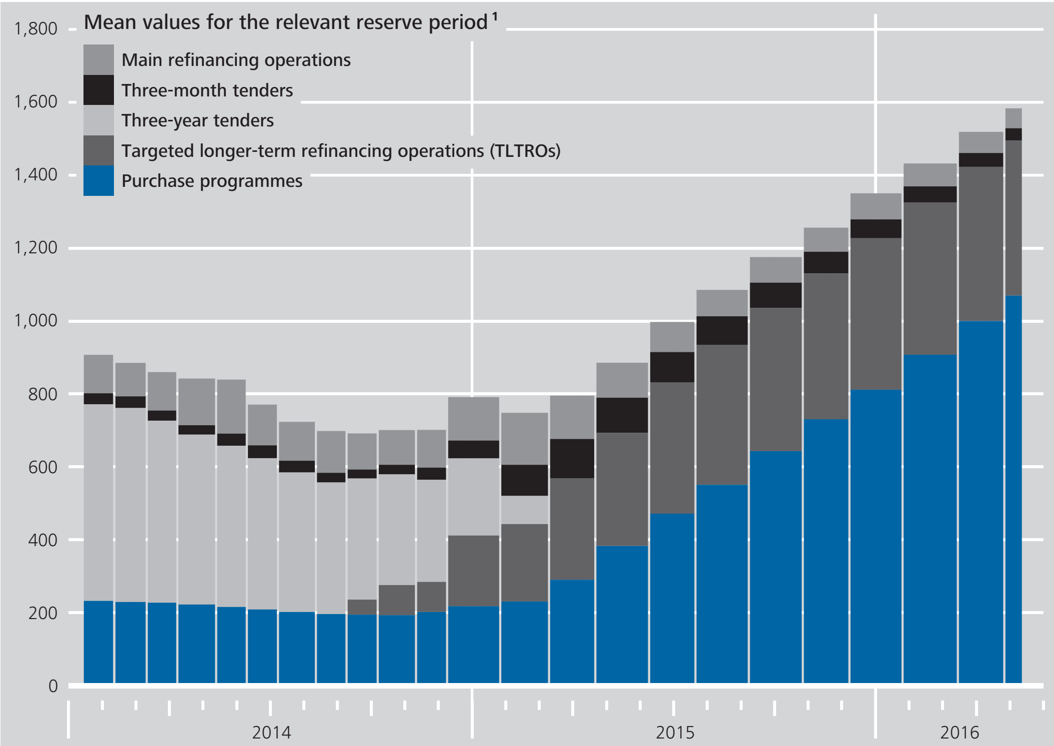
posit facility rate (as in the preceding period). As a reference rate for secured overnight money, GC Pooling Overnight (ECB basket) averaged -0.39% in the March-April 2016 reserve maintenance period. As in the previous period, this was just 1 basis point above the deposit facility rate. The March quarter-end picture was mixed. While secured overnight money in the ECB basket showed virtually no reaction, both the Extended basket, which includes Italian and Spanish government bonds, and the unsecured Eonia rate recorded day-to-day increases amid relatively high turnovers on these days, when trading is usually weak. This may have been partly due to some banks steering a shorter-term liquidity management course than usual in anticipation of participating in the first new TLTRO II on 23 June 2016. This was indicated by Eonia turnover, which rose by €4.1 billion on average against the previous period to €16.1 billion in March-April, which in a longer-term comparison is still low. In the case of secured GC Pooling turnover, trading with a one-day maturity – comprising overnight, tomorrow next (TN) and spot next (SN) – likewise increased overall in the March-April maintenance period, whereby higher overnight money trading in the Extended basket and in the TN and SN maturities offset declines in the ECB basket. GC Pooling trades with a one-week maturity likewise increased on average.

A high level of excess liquidity accumulated at the beginning of the new April-June 2016 reserve maintenance period, which was probably instrumental in pushing GC Pooling secured overnight rates distinctly below the deposit facility rate for the first time (-0.42%). That this occurred at the end of the month may have been due, *inter alia,* to balance sheet and ratio-based investment needs on that specific day, the weekend-induced month-end extension to three days and an increased need for swap transactions in the United Kingdom owing to a bank holiday there.

Outstanding liquidity following open market operations in the euro area

€ billion



1 The bar width corresponds to the length of the reserve periods. The last period displayed is still ongoing.
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tutions in the public sector purchase programme (PSPP) will be lowered from 12% to 10%. Increasing the ECB's share of PSPP purchases from 8% to 10% will maintain the regime of risk-sharing for 20% of the programme volume.

… expands it to include a corporate sector purchase programme

In addition, the APP is being expanded to include a corporate sector purchase programme (CSPP) under which investment-grade euro-denominated bonds will be purchased from non-banks domiciled in the euro area. Purchases under the CSPP, which count towards the monthly purchase volume of €80 billion, will start in June 2016 and will help to strengthen the pass-through of the Eurosystem's asset purchases to the financing conditions of the real economy. The securities must meet the requirements of the Eurosystem's collateral framework for monetary policy credit operations, *inter alia*.[1] They must have a remaining maturity of between six months and 30 years, and the Eurosystem will apply an issue share limit of 70%. The purchases will be carried out by six national central banks – including the Bundesbank – and will be coordinated by the ECB. Purchases can be conducted in both the primary and the secondary markets. Special rules apply to securities issued by entities that qualify as public undertakings – they cannot be purchased in the primary market, and the issue share limit will be lowered in line with the rules applicable to the PSPP.

ECB Governing Council adopts new series of TLTROs

Furthermore, the ECB Governing Council adopted a new series of four targeted longer-term refinancing operations (TLTRO II) to strengthen the degree of accommodation of its monetary policy and to create additional incentives to encourage lending to the real economy. These operations will be carried out on a quarterly basis and are scheduled to begin in

1 Details of the CSPP were announced by the ECB Governing Council on 21 April 2016 and published in an ECB press release.

June 2016. Participating banks will be able to borrow a total amount of up to 30% of their outstanding loans to the non-financial private sector (excluding loans to households for house purchase) as at 31 January 2016, less any amount which is still outstanding under the first two TLTRO I operations. Each operation will have a maturity of four years. Banks can make use of an additional voluntary repayment option in June 2016 for all currently outstanding TLTRO I operations while simultaneously participating in the first TLTRO II operation. The interest rate will be fixed for the entire term of each operation at the rate applicable to the main refinancing operations (MROs) at the time of allotment.

The interest rate applied to TLTRO II will be reduced retroactively for the entire term of the relevant operation if a bank's net lending exceeds its specific benchmark. As is the case for TLTRO I, different benchmarks will apply depending on whether a bank exhibited positive or negative eligible net lending in the 12-month period to 31 January 2016. The maximum interest rate reduction will be equal to the difference between the MRO rate and the deposit facility rate at the time of allotment and will be granted if counterparties exceed their benchmark for net lending by 2.5% between 1 February 2016 and 31 January 2018. If this benchmark is exceeded by between 0% and 2.5%, the size of the decrease in the interest rate will be graduated linearly. Furthermore, counterparties will not be subject to mandatory early repayments under TLTRO II, but will have the option of voluntary repayment at a quarterly frequency starting two years from the settlement of each operation.

Expansionary monetary policy stance currently justified, but measures not without risk

The subdued outlook for inflation and the Eurosystem's obligation to fulfil its price stability mandate in the medium term currently justify an expansionary monetary policy overall. Monetary policy should be viewed in terms of its impact on the economy as a whole, not on individual elements such as returns on savings deposits. Hence there is a continuing need for an appropriate discussion that considers both the potential benefits of monetary policy measures in terms of helping return inflation to levels below, but close to, 2% in the medium term and the potential risk the measures pose with regard to the ECB's mandate.

Purchase volumes still in line with target

On 6 May 2016, the Eurosystem held assets in the amount of €746.3 billion under the PSPP. The average residual maturity of the PSPP portfolio is currently eight years. The outstanding amounts purchased to date under the third covered bond purchase programme (CBPP3) and the asset-backed securities purchase programme (ABSPP) came to €174 billion and €18.9 billion respectively. In sum, the volume of securities purchased under the APP is thus in line with the previously announced average monthly volume of €60 billion (or €80 billion since April 2016).

19 banks borrow €7.3 billion in seventh TLTRO I

The seventh of eight TLTRO I operations was carried out on 24 March 2016, with 19 banks borrowing a total volume of €7.3 billion. The relatively small volume is likely to be due, among other things, to the fact that many counterparties are waiting for the allotment of TLTRO II with its more attractive terms and conditions. Other contributory factors may have been the very high and still rising levels of excess liquidity as well as the low borrowing costs in the market. Banks' demand for regular refinancing operations also diminished somewhat during the reporting period, falling by about €21 billion to €512 billion between the beginning of February and the middle of April.

Excess liquidity continues upward trend

Despite the reduced demand for monetary policy operations, the period under review saw the APP purchases drive excess liquidity levels up by some €164 billion to around €834 billion at last count, in a trend pattern observed since the launch of the APP. This increase is expected to continue and accelerate throughout the rest of this year on the back of the expanded monthly APP purchases.

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

Quarter-on-quarter change in € billion, seasonally adjusted

Assets	2016 Q1	2015 Q4	Liabilities	2016 Q1	2015 Q4
Credit to private non-MFIs in the euro area	67.5	7.7	Central government deposits	40.3	– 11.9
Loans	83.4	23.5	Monetary aggregate M3	174.2	125.1
Loans, adjusted[1]	74.7	18.1	*of which* Components		
Securities	– 15.9	– 15.8	Currency in circulation and overnight deposits (M1)	172.3	135.4
Credit to general government in the euro area	124.3	73.5	Other shorter-term bank deposits (M2-M1)	– 13.7	– 7.5
Loans	2.6	– 16.4	Marketable instruments (M3-M2)	15.6	– 2.8
Securities	121.7	89.8	MFI longer-term financial liabilities	– 63.8	– 55.2
			of which		
Net external assets	– 72.5	– 36.6	Capital and reserves	– 11.6	38.4
Other counterparts of M3	31.4	13.5	Other longer-term financial liabilities	– 52.1	– 93.7

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

Short-term money market rates follow policy rate downwards

In terms of the short-term money market rates, the period under review saw the Eonia rate temporarily dip to a new low of -0.349% following the recent 10-bp cut in the deposit facility rate. The secured overnight rate (Stoxx GC Pooling) currently spans a narrow interest rate corridor of between -0.38% and -0.40%, and fell significantly short of the deposit facility rate for the first time at the end of April owing *inter alia* to month-end effects. Short-term money market rates thus mirrored the decline in the deposit facility rate almost exactly. The unsecured three-month Euribor also continued its downward trend to reach a new all-time low of -0.256% at the current end. The spread vis-à-vis the overnight rates – which had once again briefly hovered around the 1-bp mark amid expectations of a cut in the deposit facility rate – went back up to just under 10 basis points after the cut.

Market participants revise expectations regarding further deposit rate cut

Forward rates in the money market initially responded to the ECB Governing Council's decisions of 10 March 2016 by rising distinctly after market expectations of a further cut in the deposit facility rate over the course of the year, which had partly been priced into forward rates, were revised following the ECB's press conference. However, longer-term Eonia swap and forward rates have slipped again somewhat of late, possibly due to rebounding expectations that a further cut in the deposit facility rate is on the cards towards the end of 2016 or in the first quarter of 2017.

Monetary developments in the euro area

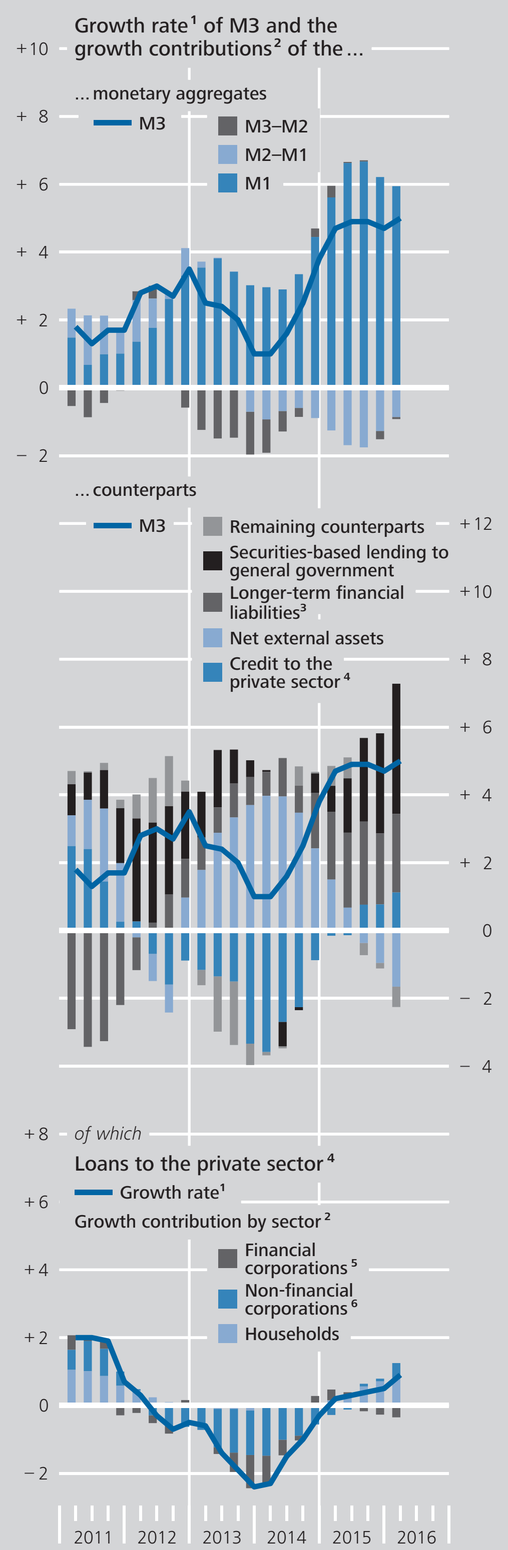
Monetary developments marked by APP and interest rate constellation

The broad M3 monetary aggregate once again saw substantial growth in the first quarter of 2016 as the money-holding sector continued to accumulate overnight deposits and interest rates fell further. In terms of its counterparts, the growth in M3 is also increasingly being supported by lending to the private sector. Against the backdrop of the ongoing economic recovery and extraordinarily low interest rates, loans to non-financial corporations, in particular, showed a striking increase. As in the preceding quarters, the Eurosystem's bond purchases also had a marked impact on monetary developments. For instance, taken in isolation, securities-based lending to general government by the MFI sector again significantly boosted monetary growth. However, this positive effect was partly offset by the outflow of funds from the euro area caused by foreign investors' net sales of euro-area government bonds.

Growth in M3 in the first quarter was again mainly driven by overnight deposits, which

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** Non-monetary financial corporations. **6** Non-financial corporations.

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Considerable M3 growth still being driven by overnight deposits

benefited from the comparatively small and decreasing interest rate spreads vis-à-vis other types of deposits, and which were accumulated by households and non-financial corporations, in particular. In addition, the non-financial private sector slightly increased its holdings of short-term deposits with an agreed maturity and redeemable deposits again for the first time in several quarters. However, this was more than offset by marked outflows by financial corporations. On the whole, the annual M3 growth rate continued the sideways trend already observed in 2015 and remained at the robust level of 5.0%.

Significant rise in lending to non-financial corporations

Monetary growth during the quarter under review was significantly boosted by a net increase in lending to the euro-area private sector. This was driven by loans to non-financial corporations, which recorded an unusually clear rise across all maturities during the first quarter (see the chart on page 31). It should be borne in mind, however, that lending growth during the quarter under review was buoyed by statistical one-off effects in the Netherlands. Unlike in the preceding quarters, this statistical one-off effect associated with notional cash pooling had a markedly positive impact in the first quarter.[2] While euro-area loan dynamics were understated in the last few quarters, they are thus likely to have been overstated in the reporting quarter.

Non-financial corporations' credit demand recovering further

The results of the Bank Lending Survey (BLS) carried out during the first quarter provide supporting evidence for the rise in lending. The respondent euro-area bank managers reported a perceptible increase in non-financial corporations' demand for loans in the first quarter of 2016, although growth was somewhat more subdued than in the previous quarter. According to the banks, demand for loans was driven mainly by financing needs for inventories and working capital as well as the low general level

2 For details of the cash pooling activities, see Deutsche Bundesbank, Monetary policy and banking business, Monthly Report, February 2016, footnote 1, p 29.

of interest rates. The banks surveyed also reported that, on balance, they had slightly eased their credit standards for loans to enterprises.

Clear country-specific differences in loan dynamics

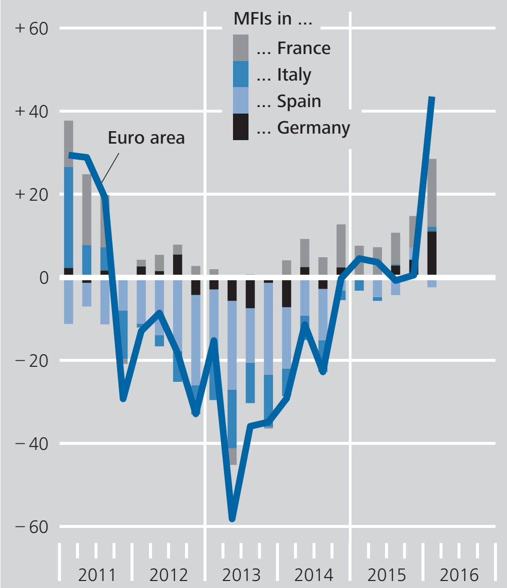
Lending to non-financial corporations picked up again significantly, especially in the two large euro-area countries of France and Germany. The ongoing economic recovery is likely to have been a major driving force behind the loan dynamics. In Italy, the upward lending trajectory observed over the past few quarters remained intact, albeit at a very low level, but lending in Spain faltered on balance during the quarter under review. Looking at the euro area as a whole, the country-specific differences have not narrowed further overall; the dispersion of national growth contributions to overall growth in lending to non-financial corporations has actually widened slightly of late. With an annual growth rate of just over 1%, the momentum of lending to non-financial corporations remains subdued in a longer-term perspective.

Moderate inflows in loans to households driven by mortgages

Net capital inflows in loans to euro-area households have remained fairly static at a moderate level for roughly a year. On account of baseline effects, though, the annual rate of growth rose again to 1.6% at the end of the quarter under review and continued to be driven by loans for house purchase. However, developments in the individual countries were mixed. While Germany, France and the Netherlands, in particular, continued to see significant loan growth, many periphery countries experienced further declines – not least as a result of the ongoing need for households to deleverage in some of these countries. For the euro area as a whole, the banks responding to the BLS reported yet another surge in household demand for loans for house purchase. The bank managers surveyed put this down to the low general level of interest rates, in the first instance, and, to a lesser extent, to the outlook on the housing market and anticipated changes in residential property prices. The banks also reported having tightened their credit standards slightly.

Loans to non-financial corporations in the euro area*

€ billion, quarter-on-quarter change, seasonally adjusted and adjusted for loan sales and securitisation



Sources: ECB and Bundesbank calculations. * Non-financial corporations. The implementation of ESA 2010 means that as from December 2014, holding companies of non-financial groups have been reclassified from the non-financial corporations sector to the financial corporations sector in banks' monthly balance sheet statistics.

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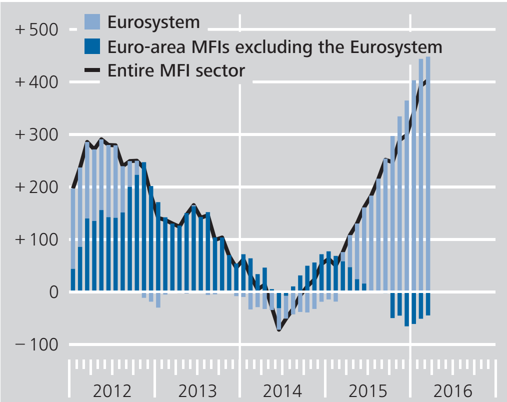
Securities-based lending of MFIs to general government in the euro area

€ billion, year-on-year change



Sources: ECB and Bundesbank calculations.

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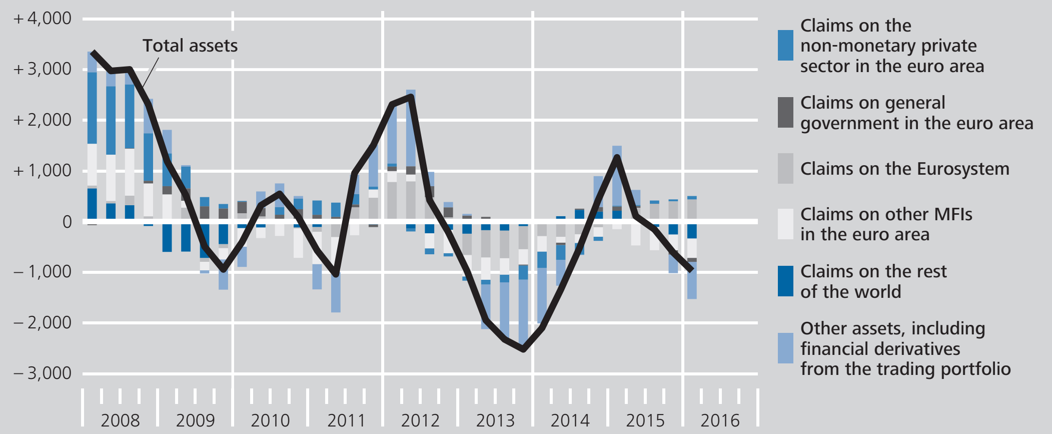
Stable growth in consumer credit

Once again, consumer credit also made a noticeable contribution to the growth in lending. Compared with loans for house purchase, the rise seen in consumer credit over the past few quarters was spread much more broadly across the euro area, which is probably a reflection of the ongoing pick-up in euro-area private con-

Balance sheet assets of euro-area banks*

€ billion, year-on-year change[1]



Source: ECB. * Including money market funds. **1** Adjusted for statistical changes and revaluations.
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sumption. This view is supported by the marked upturn in demand for consumer credit indicated by the BLS, which the surveyed banks continued to attribute mainly to consumers' buoyant spending mood. Other factors include the low general level of interest rates and the fact that consumer confidence has remained robust. Credit standards in this segment were eased marginally.

Eurosystem asset purchases supported monetary growth, …

In addition to loans to the private sector, monetary growth in the reporting quarter was primarily supported by the substantial expansion in securities-based lending to general government driven by Eurosystem purchases under the APP. As in the two preceding quarters, taken in isolation, these represented the main counterpart supporting M3 (see the table on page 29). Since Eurosystem purchases of securities from euro-area commercial banks' portfolios do not affect the MFI sector's consolidated balance sheet, the rise observed in this counterpart suggests that a sizeable share of the monetary policy-related asset purchases continued to stem from holders outside of the domestic banking sector.

… but also spurred portfolio investment outflows

On balance, however, the impact of the Eurosystem asset purchase programme on the monetary aggregate was not as great as the increase in securities-based lending to general government suggests, as the APP concurrently led to outflows of funds from the euro area to non-residents. These outflows in turn reduced the MFI sector's net external assets, thus curbing M3 growth (see the chart on page 30). For example, in the quarter under review, non-resident investors once again sold larger volumes of government bonds issued in the euro area and, on a smaller scale, also bonds of the private non-bank sector. In addition, domestic non-banks' ongoing demand for foreign debt securities led to outflows from portfolio investment. One factor behind this is likely to have been the substitution of domestic securities for foreign instruments, eg also as a consequence of sales under the APP (for Germany, see also the box on pages 34 to 37).

Continued fall in longer-term financial liabilities

MFI longer-term financial liabilities, which have been shrinking since 2011, were again a key supporting counterpart of M3 in the reporting quarter. This reduction in longer-term financial liabilities in the first quarter was influenced once more by the persistent steep decline in long-term bank debt securities held by the money-holding sector. This is likely to have been driven significantly by the cheap liquidity currently being provided by the Eurosystem in the form of targeted longer-term refinancing operations (TLTROs), rendering market-based funding unappealing to commercial banks by comparison.

Further drop in banks' balance sheet assets

Euro-area commercial banks' total assets – measured in terms of the year-on-year change – again fell noticeably in the first quarter of 2016 (see the chart on page 32). Disregarding the marked outflows from financial derivatives that affected both sides of the balance sheet in equal measure, changes to the assets side reflected the reduction in claims on non-residents recorded by credit institutions in Germany and France in particular. This was reinforced by a continued decline in interbank claims in the euro area, which was probably attributable to the credit institutions' comfortable liquidity position that is reflected, amongst other things, in the claims on the Eurosystem; these once again rose discernibly. The assets side of banks' balance sheet also reflected the impact of the APP, with Italian and Spanish banks, in particular, scaling back their holdings of domestic government bonds.

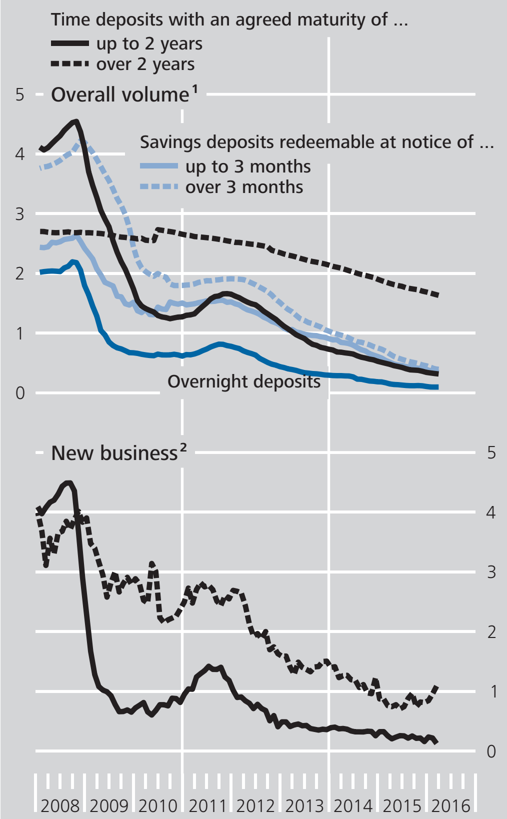
German banks' deposit and lending business with domestic customers

Deposits with German banks still dominated by build-up of overnight deposits at start of year, …

Deposits with German banks experienced significant growth in the first quarter of 2016. As in the previous quarter, this was attributable solely to increases in short-term bank deposits, with the steep rise in overnight deposits being the key determinant. Although both short-term time deposits and savings deposits likewise saw slight inflows, these had little impact on the overall short-term deposit position. The decline in the long-term counterparts of these deposits was similarly moderate. Investors continued to withdraw slowly but steadily from long-term savings deposits, while long-term time deposits also receded slightly in the quarter under review. Thus, deposit business continued to be dominated by growth in overnight deposits, most likely on account of both the preference for liquidity in the current low-interest-rate environment and the heightened uncertainty

Interest rates on bank deposits in Germany*

% pa, monthly data



* 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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prevalent on the capital markets at the beginning of the year.

… with non-financial private sector still the main driver

In terms of sectors, households once again made the greatest contribution to the sustained build-up of overnight deposits, although this growth has slowed markedly. The manner in which other financial assets components developed indicates that the inclination to search for yield was, for the first time, also a factor for this sector in 2015 (see the box on pages 34 to 37). As non-financial corporations concurrently expanded their volume of overnight deposits in the first quarter considerably more than before, there are no signs so far of a general moder-

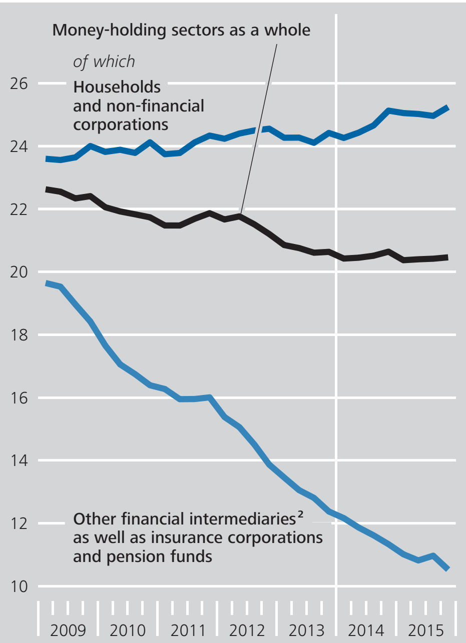
Indications of portfolio shifts into higher-yielding assets in Germany

Faced with a subdued inflation outlook, the Eurosystem has implemented a raft of monetary policy measures in recent years. These have contributed to pushing nominal interest rates on bank deposits and debt securities in Germany down to historically low levels. Moreover, the interest rate spreads for different maturities have increasingly narrowed. However, this downward yield trend does not extend to every form of investment, as evidenced by the German share index, which posted record highs in 2015.

Such a setting *per se* presents investors with incentives to take on greater risk. However, as highlighted in the May 2015 issue of the *Monthly Report*,[1] this pattern of behaviour was observed in Germany between 2009 and 2014 on balance only in the financial corporations sector[2] – ie insurance corporations and pension funds as well as other financial intermediaries (OFIs)[3]. By contrast, portfolio shifts into higher-yielding forms of investment were largely absent in the non-financial private sector, ie households and non-financial corporations; their investment behaviour was marked by continuing high risk aversion and liquidity preference. Below, we examine the extent to which these developments persisted in 2015.

Deposits as a percentage of total sectoral financial assets in Germany

Notional stocks with base year 2000,[1] %



1 Statistical changes and revaluations are hereby eliminated. **2** Including investment funds.
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As the chart below shows, the share of bank deposits in the non-financial sector's total financial assets increased only moderately in 2015, whereas financial corporations again substantially reduced the percentage of bank deposits in their financial asset portfolios.

Within the financial corporations sector, the change in bank deposit holdings in 2015 points to a heightened yield awareness, especially on the part of insurance corporations and pension funds (see the chart on page 35). On the one hand, these enterprises continued to considerably reduce their longer-term deposits at an even faster rate. On the other hand, they increased their holdings of domestic investment fund shares to a far greater degree (see the chart on page 36). At the same time, they made further purchases of debt securities, with an even stronger focus than in 2014 on foreign paper issued, above all, by euro-area MFIs

1 See Deutsche Bundesbank, Portfolio reallocations into higher-yielding assets in Germany, Monthly Report, May 2015, pp 39-41.
2 In this instance, the category of financial corporations excludes monetary financial institutions (MFIs) as the analysis relates to money-holding sectors. In addition, the following sectoral analysis disregards the general government sector as its acquisition of financial assets is comparably modest and volatile.
3 Including investment funds but excluding MFIs – and thus excluding money market funds.

and governments. This investment behaviour confirms the impression of a certain search for yield on the part of insurance corporations.

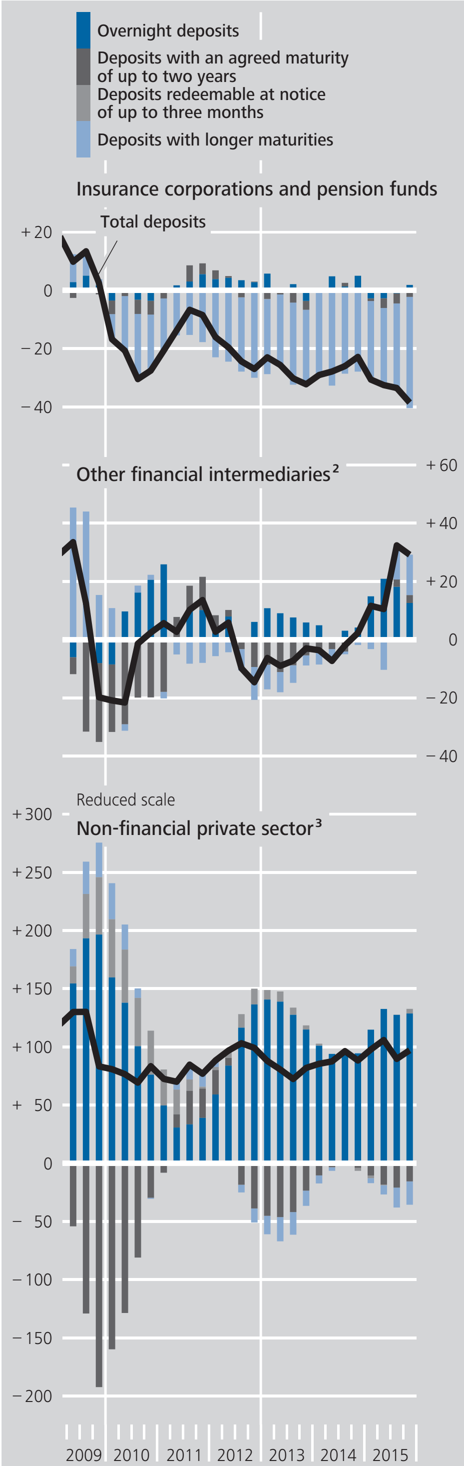
Unlike in 2014, OFIs bolstered their holdings of deposits. This expansion was mainly related to extensive securitisation transactions in the banking sector in the third quarter of 2015 which, for accounting reasons, were accompanied by a substantial rise in long-term time deposits held by financial vehicle corporations (FVCs), which are assigned to the OFI sector.[4] In addition, investment funds distinctly expanded their holdings of overnight deposits over the first six months of 2015. However, this trend did not persist in the ensuing quarters. In the course of 2015, OFIs ramped up their equity purchases, *inter alia* also augmenting their holdings of investment fund shares issued abroad while markedly cutting their investment in debt securities compared with previous years. Most of the securities bought were issued abroad. In contrast to 2014, loans to non-financial corporations in Germany were no longer relevant in net terms. In 2015, as in the period between 2009 and 2014, financial corporations in Germany thus broadly seem to have shifted assets out of bank deposits and into riskier equity instruments, in some cases intensifying their focus on foreign investments, not least for yield considerations.

By contrast, Germany's non-financial private sector in 2015 continued to show a strong preference for liquidity, with the rate of growth of deposits again somewhat up on 2014. The sector's holding of money balances was dominated by an unusually

4 If a bank securitises loans without removing them from its balance sheet, the transaction will be booked according to the countervalue received by the bank from the financial vehicle corporation for those securitised loans, typically as a long-term liability of the bank to that FVC.

Breakdown of deposits of German banks* by selected sectors

Seasonally adjusted year-on-year change[1] in € billion



* Including money market funds. **1** Adjusted for statistical changes and revaluations. **2** Including investment funds (but excluding monetary financial institutions and thus also money market funds). **3** Households as well as non-financial corporations and quasi-corporations.

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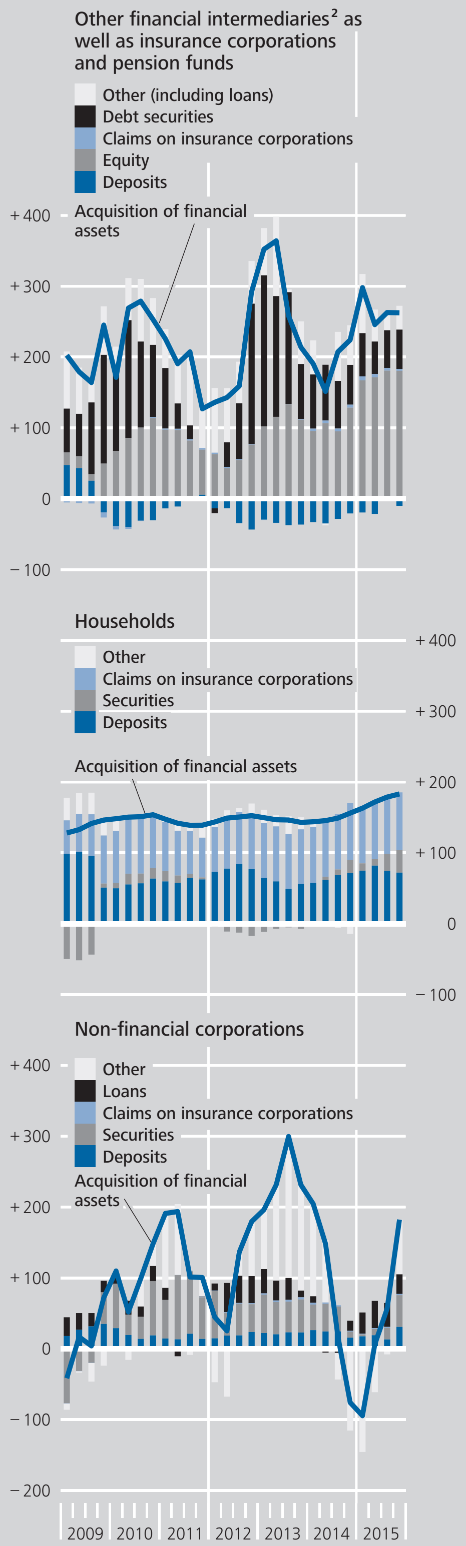
Acquisition of financial assets and its components

Four-quarter transactions in € billion[1]



1 Adjusted for statistical changes and revaluations. **2** Including investment funds.

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strong build-up of overnight deposits (see the chart on page 35). Mirroring this, both households and non-financial corporations made net disposals of short-term time deposits, while households also offloaded longer-term deposits on an even greater scale than before. The strong emphasis on holding overnight deposits is probably attributable not least to the further narrowing of the interest rate spread between such deposits and other types of deposits as well as low-risk securities. Another motive in the case of non-financial corporations was that holding on to liquid assets accumulated in the wake of buoyant profitability allows them to finance planned fixed investment using internal funds.

With respect to other forms of investment, non-financial corporations' acquisition of financial assets in 2015 proved very modest and revealed no distinct trends. In the case of households, the acquisition pattern in respect of other financial asset components indicates a stronger inclination to search for yield in 2015 than was the case among non-financial corporations. Claims on (life) insurers continued to record significant inflows of funds, which *per se* points to continued risk aversion on the part of households, and, moreover, the latter continued to run down their holdings of debt securities, particularly bank bonds (see the adjacent chart). However, this was probably also driven by the ongoing decline in net issuance of bank debt securities in Germany and the euro area, which limits new investment in such instruments.[5] However, households also markedly increased their acquisition of investment fund shares, which typically promise yields that are higher on average than those generated by bank deposits but are simultaneously less volatile than

5 See comments on monetary capital on p 32.

those from shares.[6] This indicates a perceptible active search for yield by households at the macroeconomic level for the first time since the financial crisis began and thus an acceptance of certain risks in households' financial investment choices.

Hence although the changes in the holding of deposits reflect opposite patterns of investment behaviour by Germany's financial and non-financial sectors, the respective share of German non-banks' financial assets held other than in the form of deposits indicates that the search for yield intensified to a certain extent in 2015. As expected, a greater appetite for risk was demonstrated by the financial sector, where professional portfolio managers play a leading role. While the data examined in this analysis show no clear evidence so far of any major portfolio reallocations by the money-holding sectors in Germany as a direct result of the Eurosystem's expanded asset purchase programme (EAPP) launched at the beginning of 2015,[7] the increasing search for yield that is evident in most sectors is nevertheless consistent with the objective of the expansionary monetary policy to lower the risk-free interest rate in the euro area across the entire maturity range right along the yield curve and thus to create incentives for portfolio shifts into riskier forms of investment.

6 See Deutsche Bundesbank, German households' saving and investment behaviour in light of the low-interest-rate environment, Monthly Report, October 2015, pp 26-31.
7 For example, since March 2015 sales of government bonds by the sectors under examination have not exceeded previous years' levels and have entailed rather modest volumes compared with those for other securities transactions. The finding of relatively subdued EAPP-induced direct effects on the domestic money-holding sectors is compatible with the picture presented by the monetary analysis data. These suggest that the bulk of the Eurosystem's bond purchases to date have been concluded with domestic commercial banks and foreign sellers.

ation in short-term deposit growth in net terms. In addition, non-financial corporations – as in the previous quarter – increased their short-term time deposits markedly, which was probably related to both the heightened uncertainty on the capital markets and their financial strength. In some cases, the banks responded to this additional growth in short-term deposits by lowering interest rates, at times even sending them into negative territory. While the aggregated effective rates of interest for household deposits remained positive across all maturities at the end of March, for non-financial corporations' deposits with a maturity of up to one year, this rate was slightly negative for the first time.[3] Banks reported that this mainly affected large-scale short-term corporate deposits.

Deposit business with financial corporations still characterised by search for yield

Unlike the non-financial private sector, financial corporations further reduced their bank deposits, on balance, during the first quarter of 2016. As is evident from the financial assets of this sector not held in the form of deposits, financial corporations have shown a greater propensity to take risks in recent years than households and non-financial corporations (see the box on pages 34 to 37). In this context, it can be assumed that the sector's restrained deposit growth in the quarter under review continued to be driven by the search for higher-yielding forms of investment.

Higher lending to domestic non-banks …

Banks' lending business with the domestic non-bank sector grew moderately at the start of 2016. Although banks continued to reduce their holdings of securities issued by private and sovereign entities, they considerably boosted their lending compared with the preceding quarter, especially to the private sector.

3 Calculated using the ex-post annual HICP inflation rate, the real rate of interest on corporate deposits with an agreed maturity of up to one year was likewise slightly below zero. However, this is not an unfamiliar occurrence: in the past, the real interest rate on these deposits quite often tended to be negative.

Lending and deposits of monetary financial institutions in Germany*

Changes in € billion, seasonally adjusted

Item	2015 Q4	2016 Q1
Deposits of domestic non-MFIs[1]		
Overnight	25.5	37.8
With an agreed maturity of		
up to 2 years	8.7	1.9
over 2 years	− 15.1	− 2.5
Redeemable at notice of		
up to 3 months	1.2	2.2
over 3 months	− 4.1	− 3.6
Lending		
to domestic general government		
Loans	− 5.5	2.1
Securities	− 2.0	− 4.4
to domestic enterprises and households		
Loans[2]	12.6	20.8
of which to households[3]	10.6	11.5
to non-financial corporations[4, 5]	2.1	8.1
Securities	− 1.6	− 8.7

* 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** Non-financial corporations and quasi-corporations. **5** The implementation of ESA 2010 means that 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) in banks' balance sheet statistics. Moreover, those entities and enterprises which are non-market producers (eg public 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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This rise in lending to the private sector was presumably driven by demand-side factors, such as a favourable assessment of the current setting by both households and enterprises.

… fuelled by increased loans to non-financial private sector

The lending growth was fuelled by loans to the non-financial private sector, which once again finished the quarter noticeably higher than in the preceding quarters. In addition to a significant rise in loans to households – fuelled, as in the past, by housing loans – lending to non-financial corporations also recorded a strong increase in the first quarter of 2016. Consequently, the growth rate of loans to non-financial corporations – which at the end of 2015 was 0.5% – climbed quite considerably to 1.4% by the end of the reporting quarter. By contrast, the annualised growth rate for loans to households rose only slightly from 2.8% at the end of 2015 to 2.9% at the end of the first quarter of 2016 and is therefore still below its long-run average.

Growth in non-financial corporations' demand for loans caused by various factors

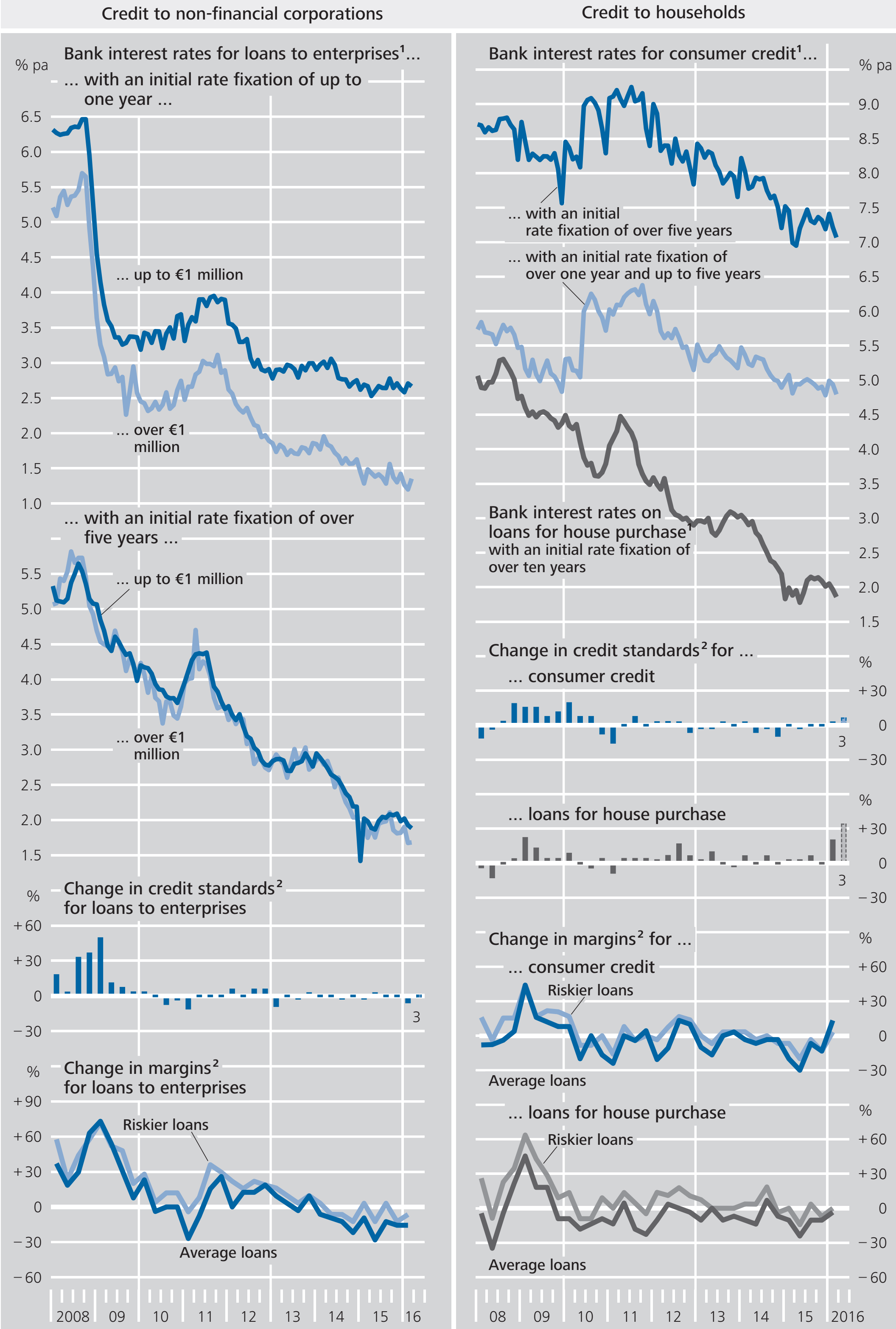
The upturn in lending to non-financial corporations comprised loans with both short and long maturities and, according to the BLS results, is attributable to increased demand. The surveyed banks put this heightened demand down to a string of different factors, such as firms' greater need for investment funds and operating capital as well as refinancing sources. But the low general level of interest rates also bolstered demand. At the end of March, domestic enterprises paid interest amounting to 2.7% for small-volume and 1.4% for large-volume loans in the short-term segment, while interest on long-term loans stood at 1.9% and 1.7% respectively of late. The lending policies of banks participating in the BLS are also likely to have supported this growth in demand, as they reported having eased their credit standards somewhat and narrowed their margins on balance.

Housing loans continue significant expansion

By contrast, the respondent banks were more restrictive when it came to lending to households for house purchase. On balance, they reported having considerably tightened their credit standards in connection with the entry into force of the Act Implementing the Mortgage Credit Directive and Amending Accounting Rules *(Gesetz zur Umsetzung der Wohnimmobilienkreditrichtlinie und zur Änderung handelsrechtlicher Vorschriften)*[4] with effect from 21 March 2016. Their margins, on the other hand, largely remained constant. The bank managers surveyed in the BLS suggested that

4 The legal provisions concern, inter alia, consumer protection information, general rules and requirements on performing services (eg in relation to business practices and employees' knowledge and skills), a prudential and civil-law obligation to assess borrowers' creditworthiness, as well as rules on early repayments, on foreign currency loans and on coupling and packaging activities.

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 somewhat" 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 somewhat" and the number of respondents reporting "narrowed somewhat" and "narrowed considerably" as a percentage of the responses given. **3** Expectations for 2016 Q2.

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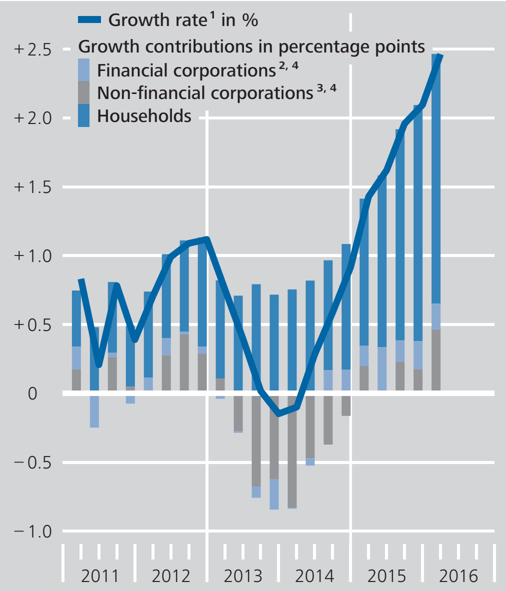
Loans of German banks to selected sectors

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** Non-financial corporations and quasi-corporations. **4** The implementation of ESA 2010 means that as from December 2014, holding companies of non-financial groups have been reclassified from the non-financial corporations sector to the financial corporations sector.

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the cause of the new significant expansion in housing loans that occurred despite this was an accelerated surge in demand for these loans from households, driven by the low general level of interest rates as well as by strong consumer confidence and refinancing requirements. In addition, bank managers were of the opinion that households were maintaining a positive outlook regarding the housing market and house price developments. According to the MFI interest rate statistics, the interest rate on long-term mortgages stood at 1.9% at the end of the first quarter and was therefore only slightly above its historic low of May 2015 since these harmonised statistics were introduced in 2003.

Consumer credit also sees appreciable inflows

In the first quarter of 2016, consumer credit, too, again recorded perceptible growth which, according to the results of the BLS, was likewise attributable to a distinct rise in demand. In this case as well, the low general interest rate level, consumer confidence and consumers' propensity to purchase were mentioned as the main reasons for this growth, while equity financing from consumer savings and borrowing from other banks had a dampening effect on funding requirements *per se*. In the consumer credit segment, the banks participating in the BLS left their credit standards virtually unchanged, while at the same time widening their margins on average loans in this line of business.

Banks' profitability weighed down by APP and negative deposit facility rate

The BLS conducted in the first quarter contained additional questions on participating banks' financing conditions, on the level of credit standards, the impact of the Eurosystem's expanded asset purchase programme (EAPP) and the consequences for credit business of the negative interest rate on the Eurosystem's deposit facility. As in the previous quarter, German banks reported a further slight improvement in their funding situation against the background of the situation in the financial markets. Their current credit standards, both for loans to enterprises and consumer credit, are at an average level relative to the midpoint of the range set by their credit standards since the second quarter of 2010, whereas their standards for loans to households for house purchase are somewhat tighter than the reference value. The banks reported that the Eurosystem's EAPP had improved their liquidity position and their funding conditions. The liquidity increase, which was used for lending, amongst other things, was almost exclusively the outcome of bank customers' portfolio shifts into bank deposits and not of the banks' own sales of securities. However, the German banks taking part in the survey also reported on a broad front that the asset purchase programme was exerting pressure on their net interest margins and thus placing a strain on their profitability, while the negative interest rate on the deposit facility had also contributed significantly to the squeeze on banks' net interest income over the past six months. Owing to the negative deposit facility rate, both lending rates and margins in all surveyed lines of business fell, whereas the volume of loans to households went up slightly.