Monetary policy and banking business

Monetary policy and money market developments

ECB Governing Council makes further cut to deposit rate

Based on its regular economic and monetary analyses, the ECB Governing Council, at its meeting on 3 December 2015, once again assessed the strength and persistence of the factors that are currently slowing the return of inflation to levels below, but close to, 2% in the medium term, and subsequently approved a further package of monetary policy measures. One decision was to lower the interest rate on the deposit facility by 10 basis points to -0.30%. The interest rates on the main refinancing operations and the marginal lending facility, meanwhile, were left unchanged at 0.05% and 0.30% respectively.

The Governing Council's decisions were motivated in part by the results of the latest Eurosystem staff projections, completed in November 2015, which indicated continued downside risks to the inflation outlook and slightly weaker inflation dynamics than previously expected. According to these staff projections, the persistence of low inflation rates reflects economic slack and headwinds from the external environment. The majority of the members of the ECB Governing Council were therefore of the opinion that further monetary accommodation was needed in order to secure a return of inflation rates towards levels that are below, but close to, 2% and thereby to anchor medium-term inflation expectations.

Governing Council modifies term of APP and …

Besides lowering the deposit facility rate, the Governing Council also decided to extend the term of the asset purchase programme (APP). The monthly purchases of €60 billion under the APP are now 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.

… other APP parameters

Another measure adopted at the meeting was to reinvest the principal payments on the securities purchased under the APP as they mature. Furthermore, the Governing Council decided that euro-denominated marketable debt instruments issued by regional and local governments in the euro area would be added to the list of assets that are eligible for regular purchases by the respective national central banks under the public sector purchase programme (PSPP).

Full allotment extended until at least end-2017

As regards monetary refinancing operations, the Governing Council also decided to continue conducting the main refinancing operations and three-month longer-term refinancing operations as fixed rate tender procedures with full allotment for as long as necessary, and at least until the end of the last reserve maintenance period of 2017.

Monetary policy stance to be reviewed in March

According to the Governing Council, the downside risks to the inflation outlook increased again at the beginning of 2016 despite the continued economic recovery. This assessment prompted the Governing Council, at its first policy meeting in the new year, to conclude that heightened uncertainty over emerging market economies' growth prospects, volatility in financial and commodity markets, and geopolitical risks raise the risk that euro-area inflation dynamics might be weaker than expected. The Governing Council therefore made an announcement on 21 January that it will review and possibly reconsider its monetary policy stance at its meeting in March, when the new macroeconomic projections become available.

Purchase volumes still in line with announced volume

On 5 February, the Eurosystem held assets in the amount of €557.3 billion as part of the PSPP, and the PSPP portfolio had an average residual maturity of eight years. The outstanding amounts purchased to date under the third covered bond purchase programme (CBPP3) and the asset-backed securities purchase pro-

Money market management and liquidity needs

The two reserve maintenance periods between 28 October 2015 and 26 January 2016 saw a marked increase in euro-area liquidity needs stemming from autonomous factors (see the table below). The figure in the December 2015-January 2016 reserve period averaged €596.8 billion, which was €39.3 billion up on its average level in the September-October 2015 reserve period, though it did fluctuate within a broad corridor between €551.6 billion and €647.3 billion over the period under review. One factor driving the stronger average demand for liquidity was the €20.4 billion net rise in the volume of banknotes in circulation, which is a typical seasonal phenomenon, especially in the run-up to Christmas. Another was the decline in the combined total of net foreign assets and other factors – which are taken together to allow for liquidity-neutral valuation effects – by €31.7 billion overall, causing liquidity to be absorbed in the same amount. Liquidity was provided, on the other hand, by the €12.7 billion net decline in government deposits to an average of €82.5 billion in the December 2015-January 2016 reserve period. The minimum reserve requirement in that reserve maintenance period stood at €113.3 billion, which was largely on a par with the figure in the September-October 2015 period.

One of the decisions which the ECB Governing Council took at its monetary policy meeting on 3 December 2015 was to cut the deposit facility rate by 10 basis points to -0.30%. The main refinancing rate at which all tender operations are currently being allotted, however, remained unchanged at 0.05% (see page 23 for details of the ECB Governing Council's other monetary policy decisions). On the whole, the outstanding tender volume barely changed during the period under review (see the chart on

Factors determining bank liquidity*

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

Item	2015/2016 28 Oct to 8 Dec	2015/2016 9 Dec to 26 Jan
I Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors		
1 Banknotes in circulation (increase: –)	– 4.1	– 16.3
2 Government deposits with the Eurosystem (increase: –)	+ 1.7	+ 11.0
3 Net foreign assets1	– 6.9	– 0.6
4 Other factors1	– 22.6	– 1.7
Total	– 31.9	– 7.6
II Monetary policy operations of the Eurosystem		
1 Open market operations		
(a) Main refinancing operations	– 4.1	+ 5.5
(b) Longer-term refinancing operations	– 2.8	+ 7.6
(c) Other operations	+ 87.5	+ 81.1
2 Standing facilities		
(a) Marginal lending facility	– 0.0	+ 0.1
(b) Deposit facility (increase: –)	– 20.3	– 23.5
Total	+ 60.3	+ 70.8
III Change in credit institutions' current accounts (I + II)	+ 28.5	+ 63.3
IV Change in the minimum reserve requirement (increase: –)	+ 0.2	– 0.2

* 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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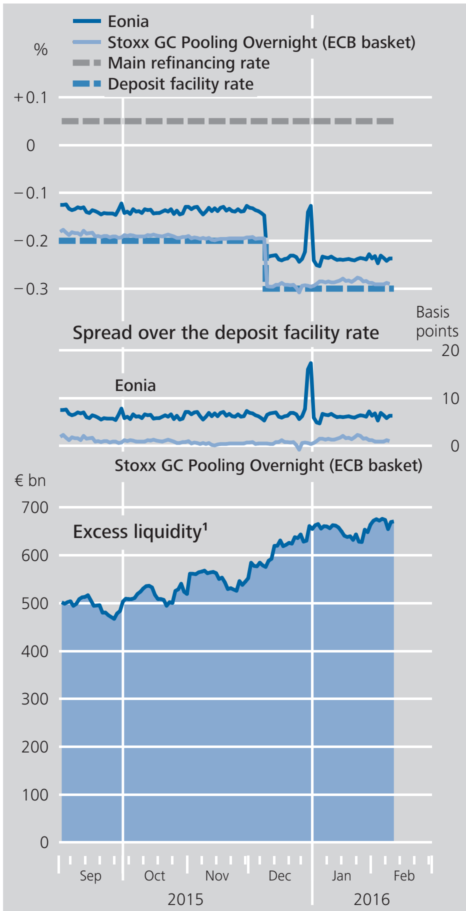
page 26), climbing by only just over €6 billion on balance to an average of just under €539 billion in the December 2015-January 2016 reserve period. The relatively low take-up of the sixth targeted longer-term refinancing operation (TLTRO) in mid-December 2015, at €18.3 billion, partly contributed to this slight growth. This raised the overall volume allotted under the TLTROs to just €418 billion, roughly speaking. At an average of around €52 billion in the December 2015-January 2016 period, refinancing volumes in the three-month tenders were just under €18 billion down on the average for the September-October 2015 period. Demand for main refinancing operations hovered between €60.5 billion and €89.0 billion in the two reserve maintenance periods under review.

Liquidity continued to be provided mainly by the Eurosystem's purchase programmes, which boosted the balance sheet holdings of securities to an average value of €812 billion in total in the December 2015-January 2016 reserve period, eclipsing the aggregate liquidity needs stemming from autonomous factors and the minimum reserve requirement. During the course of the two reserve maintenance periods under review, the balance sheet holdings of the three programmes making up the asset purchase programme (APP) climbed by €147.9 billion (PSPP), €20.0 billion (CBPP3) and €1.7 billion (ABSPP). As at 5 February 2016, these holdings stood at €557.3 billion (PSPP), €152.9 billion (CBPP3) and €17.7 billion (ABSPP). Maturities and end-of-quarter valuation adjustments, on the other hand, continued to diminish the balance sheet holdings of securities accumulated under the since-terminated Eurosystem asset purchase programmes, with holdings as at 5 February 2016 standing at €19.8 billion (CBPP1), €9.1 billion (CBPP2) and €122.0 billion (SMP).

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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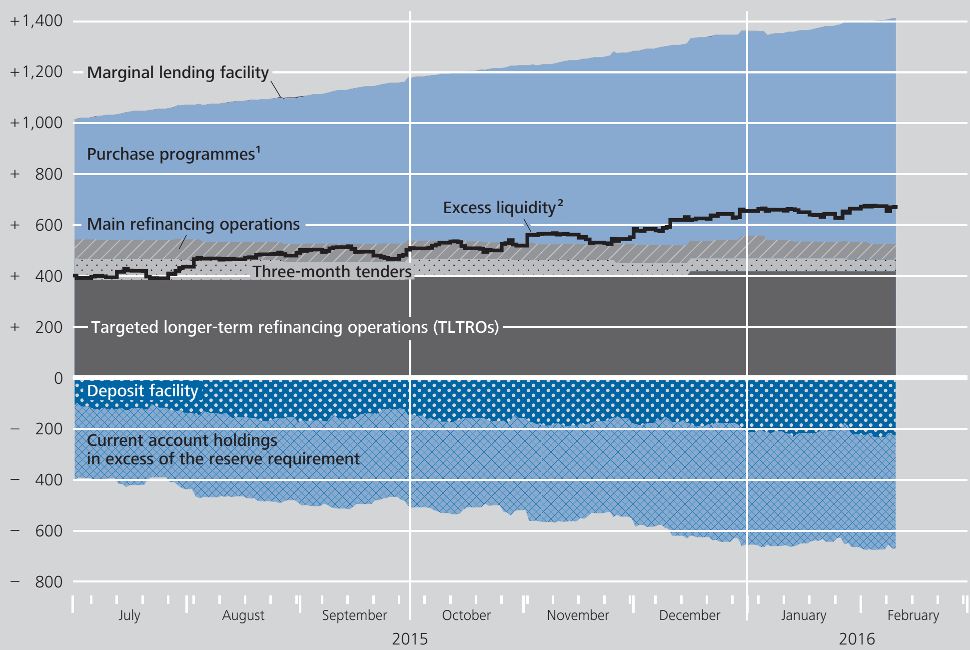
Purchases under the APP were a notable factor driving the continued increase in excess liquidity in the period under review. This grew to an average level of €640 billion in the December 2015-January 2016 reserve period and was up by €136 billion on the average in the September-October 2015 reserve period. Excess liquidity occasionally experienced spells of heightened volatility lasting just a few days, primarily as a result of swings in autonomous factors (notably government deposits with the Eurosystem).

The extremely generous liquidity supply meant that overnight rates in the period

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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under review continued to move in line with the deposit facility rate, and the reduction in the latter on 9 December 2015 was no exception (see the chart on page 25). Eonia was running at an average rate of -0.23% in the December 2015-January 2016 reserve period, 7 basis points up on the deposit facility rate (previous reserve maintenance period: 6 basis points). The reference rate for secured overnight deposits – GC Pooling Overnight (ECB basket) – was lower than Eonia throughout the period under review, averaging -0.29% in the December 2015-January 2016 reserve period. As in the previous period, this was just 1 basis point up on the deposit facility rate, even though the latter had been cut. Since Eonia and GC Pooling Overnight (ECB basket) responded almost identically to the reduction in the deposit facility rate by almost exactly following suit, the spread between the two benchmark rates remained unchanged at 6 basis points on average in both reserve maintenance periods under review. The high volumes of excess liquidity meant that end-of-month pressures ceased to have an impact on secured GC Pooling Overnight (ECB basket) rates in the period under review, while the end-of-month hikes in Eonia in October and November 2015 were marginal at best. Only at the end of the calendar year did Eonia show a relatively clear, albeit short-lived and seasonal increase of 8 basis points on 30 December 2015 compared with one day previously, though turnover was admittedly very low. Average Eonia turnover, which had already been very weak in the September-October 2015 reserve period at €15.9 billion, amounted to just €10.0 billion in the October-December 2015 period and to €12.4 billion in the December 2015-January 2016 period. GC Pooling Overnight (ECB basket) turnover likewise diminished, averaging €6.3 billion in the two periods under review, compared with €8.8 billion in the September-October 2015 period.

gramme (ABSPP) came to €152.9 billion and €17.7 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.

55 banks borrow €18.3 billion in sixth TLTRO

The sixth of a total of eight targeted longer-term refinancing operations (TLTROs) was allotted on 11 December 2015. With excess liquidity climbing from an already very high level, and wholesale funding available at low cost in the matching maturity bracket of up to three years, 55 institutions took up a total volume of €18.3 billion. The allotted volume was in line with market expectations.

Recourse to regular refinancing operations stable overall

Demand for regular refinancing operations surged temporarily on account of the usual year-end effects, but the ample liquidity levels meant the upturn was much flatter than in recent years. The Eurosystem's total monetary policy refinancing volume peaked at just under €560 billion before falling back to a little less than €526 billion at the end of January, which is roughly where it stood at the end of the last reporting period in October.

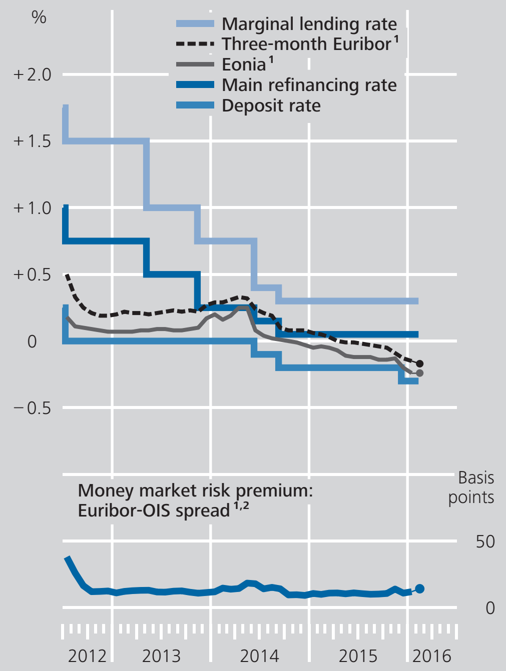
Significant growth in excess liquidity persists

The period under review saw the APP purchases drive excess liquidity levels still higher to around €674 billion at last count, in a trend pattern observed in recent months that looks set to continue for the remainder of this year on the back of continued APP purchases.

Short-term money market rates follow policy rate downwards

Among short-term money market rates, the period under review saw the Eonia rate dip to a fresh low of -0.253%, a decline which largely reflected the 10-bp cut in the deposit facility rate. Abundant excess liquidity levels meant that the temporary upturn at the turn of the year was milder than it had been one year earlier. The secured overnight rate (Stoxx GC Pooling), which was running at -0.291% when this report went to press, was likewise roughly 10 basis points down on its level prior to the cut in the deposit facility rate, meaning that it, too, moved broadly in lockstep with the policy rate. In effect, then, the deposit facility rate is acting as a cap on the downside potential in money market rates. Similarly, the unsecured three-month Euribor also continued its trend decline to mark a new all-time low of -0.169% at the current end, sending the spread between the three-month Euribor and Eonia – which had briefly hovered around the 1-bp mark amid expectations of a cut in the deposit facility rate – back up to just under 10 basis points.

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 10 February 2016.
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Market expectations regarding further cut in deposit rate

Forward rates in the money market initially responded to the Governing Council's 3 December meeting by spiking higher after market expectations of a stronger cut in the deposit facility rate that had partly been priced into forward rates were dashed. Eonia swap and forward rates have been back on a downward path recently, steepening their descent after the announcement of the Governing Council's decisions on 21 January in a possible indication of rebounding expectations that a further cut

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

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

Assets	2015 Q4	2015 Q3	Liabilities	2015 Q4	2015 Q3
Credit to private non-MFIs in the euro area	5.7	54.9	Central government deposits	– 12.0	22.0
Loans	21.7	– 7.8	Monetary aggregate M3	125.1	119.3
Loans, adjusted[1]	16.5	– 2.6	*of which* Components		
Securitised lending	– 16.0	62.6	Currency in circulation and overnight deposits (M1)	129.8	143.3
Credit to general government in the euro area	70.9	112.1	Other shorter-term bank deposits (M2-M1)	– 8.6	– 32.3
Loans	– 17.4	– 10.2	Marketable instruments (M3-M2)	3.9	8.3
Securitised lending	88.4	122.3	MFI longer-term financial liabilities	– 53.7	– 37.3
			of which		
Net external assets	– 35.1	– 63.9	Capital and reserves	40.4	18.0
Other counterparts of M3	17.8	0.9	Other longer-term financial liabilities	– 94.2	– 55.4

* Adjusted for statistical changes and revaluations. **1** Adjusted for loan sales and securitisation.
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in the deposit facility rate is on the cards before the end of 2016.

Monetary developments in the euro area

Monetary developments marked by APP and interest rate constellation

The broad monetary aggregate M3 remained on a robust growth path in the autumn quarter, propelled by an appreciable rise in loans to the private sector, which thus continued their upbeat trend, and – as in the previous quarter – the Eurosystem's asset purchases. On balance, the MFI sector's securitised lending to general government once again stood out as the main counterpart driving monetary growth in the last three months of the year. On the other hand, the Eurosystem's asset purchases simultaneously had a negative effect on M3 growth, as asset-shedding by non-euro-area residents and a shift by euro-area investors into non-euro-area assets impacted the money stock negatively. The chief money component fuelling the expansion of M3, meanwhile, was the continued strong preference among money-holders for highly liquid assets, a stance which was spurred by the interest rate constellation.

Overnight deposits still driving strong M3 growth

Overnight deposits were the chief beneficiary here, attracting continued strong demand primarily among households as a result of the relatively narrow and diminishing interest rate premiums offered by other deposit vehicles. The inflow into overnight deposits of non-financial corporations, meanwhile, was somewhat smaller than it had been one quarter earlier. Demand from the non-financial private sector for short-term time deposits eased again noticeably, but by less than it had done in the third quarter. Aggregate inflows were once again up slightly on the quarter, but a base effect caused the annual M3 growth rate to contract marginally to 4.7%. All things considered, the year 2015 as a whole saw the money stock move sideways at a robust level.

Growth in money stock still far stronger than loan growth

Despite the net inflows seen in the reporting quarter, a base effect prevented the annual growth rate of loans to the euro-area private sector (adjusted for sales and securitisation) from continuing its recovery, stagnating at 0.4% at the end of December. That is admittedly well short of the annual M3 growth rate, but the shortfall can be explained arithmetically by the increase in securitised lending to general government and the reduction in MFI longer-term financial liabilities.

Growth in loans to the euro-area private sector in the fourth quarter was mainly propelled by loans to the non-financial private sector and, to

Loans to non-financial corporations in four major countries still on the rise, …

a lesser extent, by increasing (rather than contracting, as in the previous two quarters) lending to the financial corporations sector. Loans to non-financial corporations in all four major euro-area countries continued to stabilise in the quarter under review, some to a greater extent than others (see the chart on page 30). While banks in Germany and France ramped up their lending activity discernibly, and Spain, too, saw its first increase in five years, in Italy, net redemptions were slightly up on the quarter, but the upward movement seen in recent quarters remained intact.

… one-off effect in a smaller core country causes downward bias in euro-area developments

In the euro area as a whole, loans to non-financial corporations, which only returned to expansion mode in net terms in the first half of 2015, contracted slightly on balance in the fourth quarter, just as they had done one quarter earlier. Stronger medium and longer-term lending was eclipsed by the substantial net redemptions of short-term loans. However, a country breakdown reveals that the drop in short-term lending was down to statistical one-off effects in the Netherlands,[1] just as it had been one quarter earlier, which probably meant that in the reporting quarter, the reported figures understate the actual loan dynamics. The annualised growth rate for loans to non-financial corporations in the euro area shrugged off these one-off effects and took another small step on the path to recovery, closing the quarter under review with a marginally positive

1 Much of the negative outflow seen in the quarter was probably down to notional cash pooling by euro-area non-financial corporations with bank accounts in the Netherlands. Cash pooling is the process of moving the cash held by various enterprises (eg members of a multinational group) into a single bank account as a way of optimising liquidity management. Notional cash pooling means that the enterprises in question each continue to operate their bank accounts. The bank operating these accounts treats them as a single bank account, but it is not allowed to net out the resulting receivables and liabilities, thereby extending that bank's balance sheet. As a result, the amounts that would be netted in effective (ie genuine) cash pooling also cause an upward bias in the monetary series; movements based on actual transactions would normally be many times smaller. Further details can be found in De Nederlandsche Bank, DNB expands statistics on monetary financial institutions, Statistical News Release, 27 October 2015.

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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Loans to non-financial corporations*

€ 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 assigned not to the non-financial corporations sector but to the financial corporations sector in banks' monthly balance sheet statistics.

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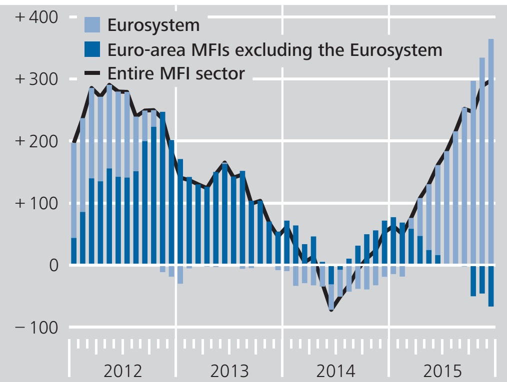
Securitised lending of MFIs to general government in the euro area

€ billion, year-on-year change



Sources: ECB and Bundesbank calculations.

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growth rate of 0.3% thanks to an improved showing in the first half-year.

Credit demand from non-financial corporations continuing to rebound

The Bank Lending Survey (BLS) carried out in the fourth quarter suggested that credit demand from the non-financial corporations sector was continuing to pick up. Although the euro-area banks surveyed said that they had, on balance, eased their standards for business loans only marginally, they also reported that demand among non-financial corporations for bank credit had soared in the final quarter of 2015 with a vibrancy last seen in the fourth quarter of 2006. The banks attributed this demand primarily to the low general level of interest rates and, to a lesser extent, to the funding which businesses needed for their investment, inventories and working capital.

Distinct rise in loans to households driven by loans for house purchase

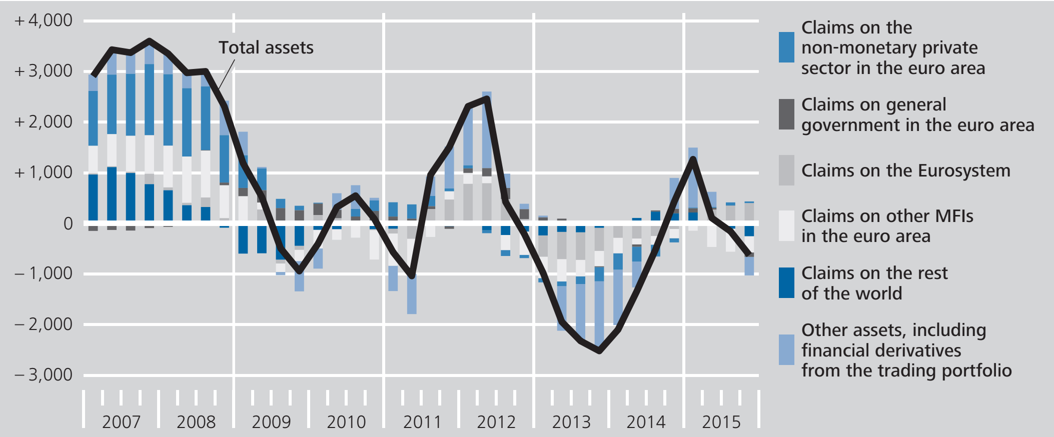
Growth in loans to euro-area households stalled in the quarter under review at a moderate annualised growth rate of 1.4% in December 2015. With interest rates mired at historically low levels, household demand for credit was yet again fuelled chiefly by loans for house purchase, although consumer credit made another distinctly positive contribution. As in the preceding quarters, loans for house purchase were up across the euro area as a whole, but developments in the individual countries were rather more mixed. While Germany in particular saw continued strong loan growth, many periphery countries experienced a decline – 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 surveyed in the BLS reported yet another surge in household demand for loans for house purchase, along with a slight easing of credit standards.

Growth stable in consumer credit

Compared to loans for house purchase, the rise seen in consumer credit over the past few quarters was spread much more broadly across the euro area, probably in a reflection of the ongoing pick-up in private consumption in the euro area. This view is backed by the renewed sharp upturn in consumer credit volumes indicated by the BLS. The BLS respondents continue to mainly attribute this upturn to strong consumer spending habits, besides the robust consumer confidence and low interest rates. Credit standards in this segment remained virtually unchanged.

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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Eurosystem securities purchases drive monetary growth, …

As mentioned above, monetary growth was driven not only by loans to the private sector, but predominantly by the large expansion in securitised lending to general government, which once again represented the main counterpart supporting M3 (see the table on page 28). The somewhat lower quarter-on-quarter growth is attributable to commercial banks reducing their holdings of domestic government bonds to a considerably greater extent in the fourth quarter than in the preceding quarters (see the chart on page 30). However, the bulk of the Eurosystem's asset purchases to date have ultimately originated from holders outside the domestic banking sector. The reduction of securitised lending by euro-area banks affected both government bonds and, to a noticeable extent, debt securities in the domestic private sector. This contrasted with only minor equity inflows.

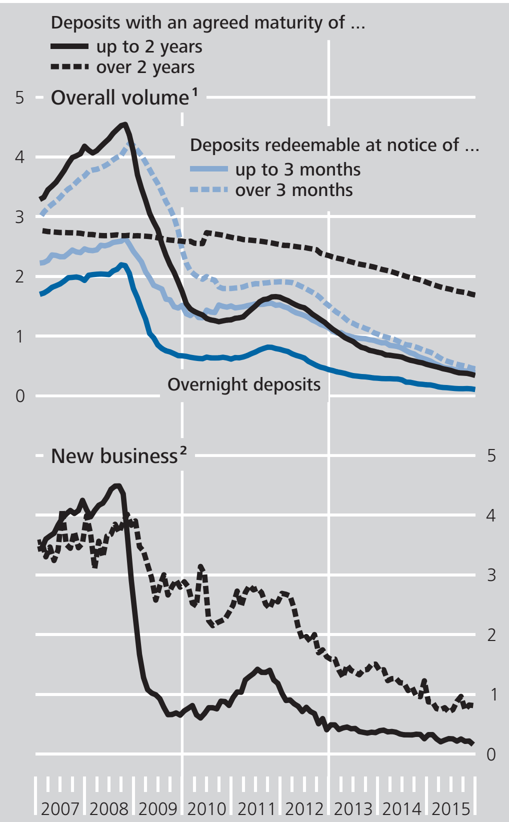
… but also capital exports from portfolio investment

While securitised lending to general government in the euro area from the MFI sector as a whole mainly supported monetary growth from the launch of the PSPP, there were net outflows of funds from the euro area to non-residents in the same period. The contribution to M3 growth by the MFI sector's net external assets had, therefore, become increasingly negative since mid-year (see the chart on page 29). As a result of the ongoing current account surpluses, euro-area non-banks in the reporting quarter continued to record inflows of funds from abroad which, taken in isolation, fuelled monetary expansion. However, the inflow of funds arising from trade in goods and services was again more than outweighed by outflows from portfolio transactions. These outflows were probably attributable to PSPP-induced capital movements, in particular, although additional factors such as the monetary policy decisions by the Eurosystem and the US Federal Reserve (Fed), too, are likely to have had an impact on securities transactions with non-residents in the final quarter. For example, non-resident investors continued to sell government bonds issued in the euro area and, to a marked extent, also bonds of the non-financial private sector. Moreover, the outflows from securities transactions were, above all, driven by the sustained high demand from domestic investors in the non-bank sector for debt securities issued outside the euro area. One factor behind this is likely to have been the substitution of domestic securities sold to the Eurosystem under the APP with foreign securities.

MFI longer-term financial liabilities, which had at times been the largest supporting M3 counterpart in the preceding quarters, slowed down perceptibly in the reporting quarter as well.

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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Further decline in longer-term financial liabilities due to shrinking long-term forms of investment

Against the backdrop of the flat yield curve, long-term time deposits and long-term bank debt securities, in particular, continued to decline. Moreover, the consistently significant net redemptions of bank debt securities held by the money-holding sector are likely to have been driven by the liquidity currently provided by the Eurosystem at favourable conditions and by inflows of deposits, rendering market-based funding unattractive by comparison. The Eurosystem's CBPP3, too, is likely to have spurred the reduction in bank debt securities held by the money-holding sector.

Banks' asset items discernibly lower in 2015

Euro-area commercial banks' total assets fell noticeably in 2015 (see the chart on page 31). Disregarding the marked outflows from financial derivatives that affected both sides of the balance sheet in equal measure, the decline on the liabilities side was mainly attributable to the lower issuance of bank debt securities. The assets side reflected the reduction in claims on non-residents and – as part of the APP – on general government in the euro area. The latter applied, above all, to banks in France, Italy and Spain, which scaled back their holdings of domestic government bonds. Credit institutions in France and Germany, in particular, reduced their external claims. The continued decline in interbank claims in the euro-area is probably attributable to the financial institutions' generally comfortable liquidity position, which is reflected, amongst other things, in the banks' claims on the Eurosystem, which rose discernibly.

German banks' deposit and lending business with domestic customers

Deposit growth in low-interest-rate setting still dominated by build-up of overnight deposits …

Once again, there was a distinct rise in deposit business in Germany in the fourth quarter of 2015. As in the previous quarters, this was attributable solely to the development of short-term bank deposits. Long-term deposits declined considerably after they had risen perceptibly in the previous quarter owing to a large-volume securitisation transaction. Besides overnight deposits, for the first time in six quarters, short-term time deposits contributed to the positive development of deposits in the reporting quarter. In view of the heightened uncertainty in the capital markets, this relatively liquid and safe form of deposit was apparently seen again as a comparatively attractive investment alternative.

… and driven mainly by the non-financial private sector

From a sectoral perspective, households continued to make the greatest contribution to the sustained build-up of overnight deposits. Non-financial corporations, too, expanded their volume of overnight deposits and, for the first time in just under two years, increased their short-term time deposits markedly, whereas their remaining bank deposits continued to stagnate. The increase in liquid bank deposits benefited from the interest rate gap narrowing further compared with other forms of deposit (see the chart on page 32), households' rising disposable incomes and non-financial corporations' high levels of liquidity.

Deposit business with financial corporations still characterised by search for yield

Compared with the previous quarter, financial corporations in the reporting quarter likewise showed somewhat greater interest in more liquid bank deposits. However, on balance, financial corporations slimmed down their deposits held with domestic banks in the reporting quarter by again considerably reducing long-term time deposits. Consequently, the development of deposits in this sector is likely to have continued to be driven by the search for higher-yielding forms of investment.

Discernibly less lending business with domestic non-banks on balance

Following a significant expansion in the preceding quarter, banks' lending business with the domestic non-bank sector weakened discernibly in the final quarter of 2015. This was due, above all, to banks reducing their holdings of securities issued by private and sovereign entities, which they had stocked up on markedly in the preceding quarter. Moreover, the decline in unsecuritised loans to the public sector accelerated, not least reflecting the public sector's lower funding needs as a result of its currently favourable budget situation.

By contrast, continued increase in loans to the private sector due mainly to vibrant demand for loans for house purchase

By contrast, as in the previous quarters, banks recorded a noticeable increase in lending to the domestic private sector, which was essentially due to yet another considerable rise in loans to households. The increase in lending to this sector has been characterised by the trend of rising demand for housing loans since 2010. In the reporting quarter, too, the sound income and asset situation of households combined with the lack of attractive investment alternatives helped stimulate demand for housing and, thus, also for housing loans. In addition, the interest rate level remains exceptionally low. The interest rate on long-term loans for house purchase stood at 2.0% at the end of the reporting quarter and was, therefore, close to its historic low of May 2015 since the introduction of harmonised MFI interest rate statistics in 2003.

Indications of further determinants are provided by the latest BLS results, which suggest that, besides the low general interest rate level, demand by households for housing loans was additionally supported by households' persistently positive outlook regarding the housing market and house price developments. By con-

Lending and deposits of monetary financial institutions in Germany*

Changes in € billion, seasonally adjusted

Item	2015 Q3	2015 Q4
Deposits of domestic non-MFIs[1]		
Overnight	33.1	25.7
With agreed maturities		
of up to 2 years	– 3.8	8.4
of over 2 years	12.9	– 15.1
Redeemable at notice		
of up to 3 months	1.8	1.2
of over 3 months	– 4.4	– 4.1
Lending		
to domestic general government		
Loans	– 2.6	– 5.5
Securitised lending	5.1	– 2.1
to domestic enterprises and households		
Loans[2]	13.8	12.6
of which to households[3]	11.7	10.6
to non-financial corporations[4, 5]	2.0	2.1
Securitised lending	9.3	– 1.3

* As well as banks (including building and loan associations, but excluding the Bundesbank), monetary financial institutions (MFIs) here also include money market funds. End-of-quarter data, adjusted for statistical changes 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, 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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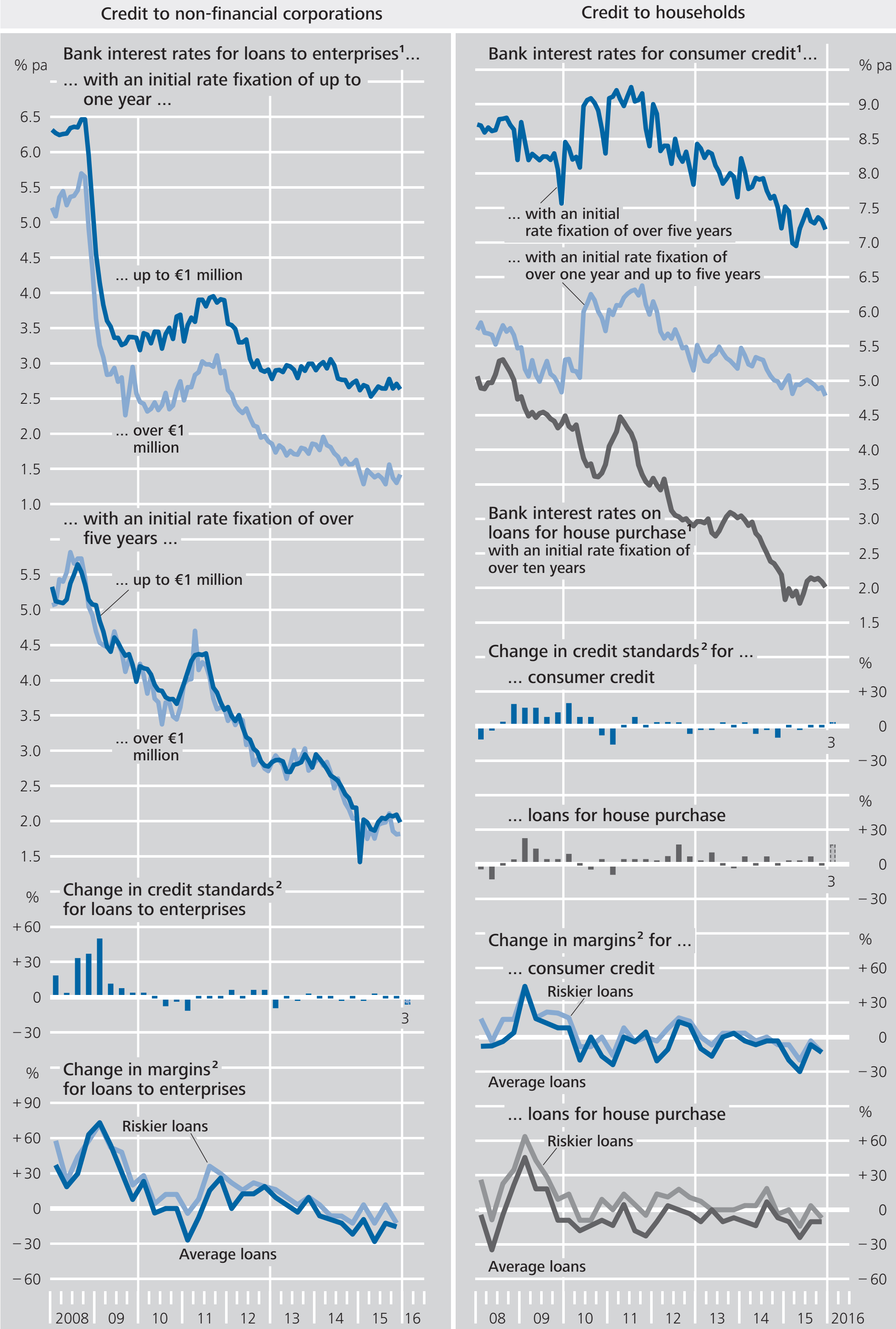
Banking conditions in Germany



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 Q1.

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trast, taken in isolation, the fact that households drew on own funds and took out loans with other banks to make purchases exerted a dampening effect on the borrowing requirements vis-à-vis credit institutions participating in the BLS.

Virtually no change in German banks' lending policy on loans for house purchase

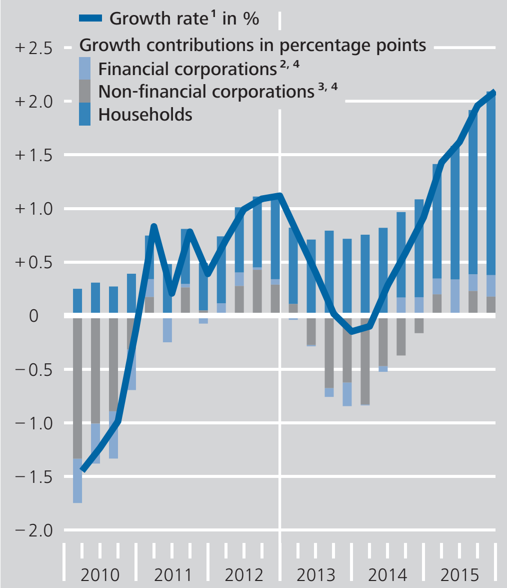
The lending policy of BLS respondent banks did not counteract the vibrant demand for loans for house purchase. Credit standards for housing loans remained unchanged, while margins even narrowed somewhat on balance. Based on the credit standards which have either remained unchanged or, in some cases, been tightened in this segment over the last few years, the respondent institutions did not take on higher lending risks by lowering their minimum requirements vis-à-vis potential borrowers. However, the favourable economic climate suggests that it is likely that a greater number of credit applicants met the banks' unaltered requirements or more households showed interest in borrowing funds, as a result of which banks were able to grant a larger amount of loans. Nevertheless, the current growth in housing loans granted to households, with an annual rate of 3.5%, remained moderate on the whole and, for a prolonged period of time since 1981, fell distinctly short of the long-term average by historical standards.

Marked increase in consumer credit

According to the BLS results, demand for consumer credit in the fourth quarter of 2015 did not have as much traction as in the previous quarters. According to the bank managers surveyed as part of the BLS, the lending business of other banks, amongst other things, had a dampening effect in this segment, whereas the low general interest rate level and consumers' robust propensity to purchase fuelled demand. Overall, aggregated across all reporting banks in Germany, these favourable underlying conditions were reflected in a noticeable increase in consumer credit to households. This was consistent with the banks participating in the BLS reporting that they had adjusted their lending standards in a similar way to those in the housing loan segment. The standards for consumer credit remained unchanged, whereas margins were tightened slightly.

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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Distinct rise in lending to non-financial corporations due to low interest rates and heightened investment activity

A distinct rise was also recorded in lending to non-financial corporations, which in Germany continued to exhibit a strong preference for long-term loans. However, unlike in the two previous quarters, there was also demand from non-financial corporations for medium-term loans, albeit to a much lower extent. Non-financial corporations' demand for loans in the reporting quarter was fuelled by the increase in borrowing costs in the capital market and a simultaneous rise in borrowing requirements. The latest BLS results generally underpin this assessment. According to the banks participating in the BLS, the demand for bank loans by non-financial corporations gained a great deal of momentum in the fourth quarter. The respondent bank managers mainly attributed this substantial expansion to the quarter-on-quarter increase in financing needs for fixed investment purposes. The low interest rate level, too, served to stoke demand. For example, at the end of December, domestic enterprises paid interest amounting to 2.6% for small-volume and 1.4% for large-volume loans in the short-term segment, while interest on long-term loans stood at 2.0% and 1.8% respectively of late. Additional positive stimulus to demand for loans was exerted, according to the BLS, by the financing needs of enterprises for refinancing, restructuring and renegotiating. By contrast, taken in isolation, enterprises' recourse to alternative sources of funds had a dampening effect on demand. However, the respondent banks' credit standards remained virtually unchanged in the final quarter. Lending standards therefore remained unchanged on balance and only margins fell markedly.

Further improvement in banks' capital position

The BLS conducted in the fourth 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. Against the backdrop of the situation in the financial markets, German banks again reported a marginal improvement in their funding situation compared with the previous quarter. Regarding the new regulatory and supervisory activities, the second half of 2015 saw the banks reduce their risk-weighted assets further on balance and significantly strengthen their capital position again. As had been the case in the preceding TLTROs, the surveyed institutions showed only muted interest in the December 2015 TLTRO. Those banks which did participate cited the attractive TLTRO terms as the main reason for doing so. They stated that the borrowed funds were to be used chiefly for lending, in keeping with these monetary policy operations' objective. All in all, the TLTROs have led to a slight improvement in the participating banks' financial situation, although institutions are not expecting any impact on their credit standards.