

Monetary policy and banking business

Monetary policy and money market developments

Key interest rates left unchanged

Based on its regular economic and monetary analyses, the ECB Governing Council decided to keep key interest rates unchanged in the reporting period. Therefore, the main refinancing rate remains at 0%, while the marginal lending rate stands at 0.25% and the deposit facility rate at -0.40%. The Governing Council continues to expect the key ECB 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. Furthermore, the Eurosystem continued its purchases as part of the expanded asset purchase programme (APP) as planned. 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 objective of achieving inflation rates below, but close to, 2% over the medium term.

Forecast for 2016 HICP rate revised slightly upwards of late

The Eurosystem staff projections drawn up in the reporting quarter revised the forecast for the Harmonised Index of Consumer Prices (HICP) rate, lifting the projected rate slightly compared with March to an average of 0.2% for 2016. For 2017, headline inflation is projected to rise sharply to 1.3% on the back of upward base effects in the energy component. As for 2018, the declining economic slack is expected to push up inflation somewhat further (to 1.6% in the baseline scenario). The Eurosystem projections are, therefore, largely consistent with the results of the ECB's current Survey of Professional Forecasters (SPF). Beyond these projections, the experts surveyed as part of the SPF expect a further increase (to 1.8%) in the average inflation rate for 2021.

At its monetary policy meeting in July 2016, the ECB Governing Council discussed the consequences of the referendum on the United King-

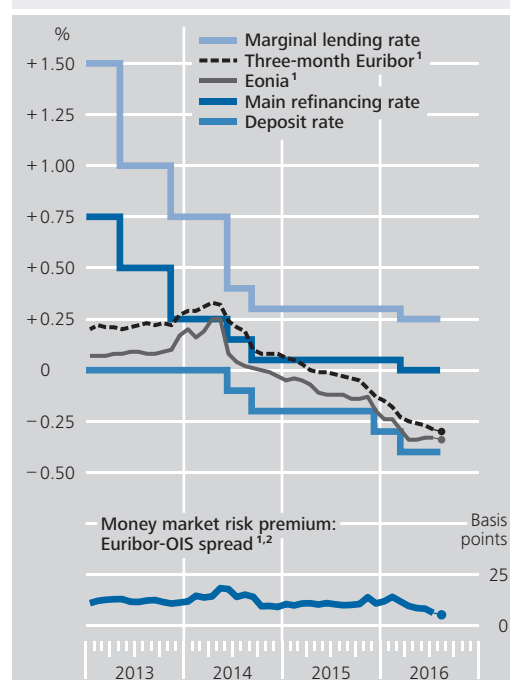
dom's membership of the EU for the euro area. The conclusion drawn was that the baseline scenario of an ongoing economic recovery and rising inflation rates in the euro area was still on course. Owing to the heightened uncertainty brought on by the outcome of the referendum, amongst other factors, the ECB's Governing Council did, however, announce that it would closely monitor the outlook for price stability and reassess the most likely path of inflation as well as the risks over the coming months based on newly available information.

ECB Governing Council still sees intact baseline scenario of a recovering economy and higher inflation

On 29 June 2016, the eighth and final targeted longer-term refinancing operation of the TLTRO I series launched in June 2014 was conducted. This operation saw 25 institutions taking up an overall volume of €6.7 billion. Simultaneously, the first of a total of four new targeted longer-term refinancing operations

514 banks borrow €399.3 billion in first TLTRO II

Money market interest rates in the euro area



Sources: ECB and Bloomberg. 1 Monthly averages. 2 Three-month Euribor less three-month Eonia swap rate. • Average 1 to 11 August 2016.

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Money market management and liquidity needs

The two reserve maintenance periods between 27 April 2016 and 26 July 2016 saw a marked increase in euro-area liquidity needs stemming from autonomous factors (see the table below). Compared with the average figure for the March-April 2016 maintenance period, ie the last period before the observation period, these needs rose by €78.8 billion to average €765.9 billion during the June-July 2016 period, fluctuating within a broad corridor of between €635.4 billion and €829.0 billion. Much of this increase in average liquidity needs was attributable to the rise in government deposits, which increased by a total of €28.1 billion net. On balance, however, an even stronger driving factor was the decline in the combined total of net foreign assets and other factors – which are considered together because of liquidity-neutral valuation effects – by €32.9 billion overall, causing liquidity to be absorbed in the same amount. In addition, the €17.8 billion rise in

banknotes in circulation, based on compared averages, that was observed during the period under review had the same effect. The minimum reserve requirement rose across the two reserve periods by a total of €1.5 billion to €115.8 billion in the June-July 2016 period, thus additionally pushing up the arithmetical needs.

The outstanding tender volume totalled around €519 billion on average in the June-July 2016 period, almost unchanged compared with the March-April 2016 average. The period under review saw the allotment of the first of a new series of four targeted longer-term refinancing operations (TLTRO II) as well as the voluntary early repayment of the completed operations one to seven in the first series (TLTRO I) and the execution of the eighth – and final – TLTRO in this series. All these operations shared the value date 29 June 2016. In the case of the first TLTRO II, where the allotment rate can lie

Factors determining bank liquidity*

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

Item	2016	
	27 April to 7 June	8 June to 26 July
I Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors		
1 Banknotes in circulation (increase: –)	– 7.3	– 10.5
2 Government deposits with the Eurosystem (increase: –)	+ 23.5	– 51.6
3 Net foreign assets ¹	+ 13.0	+ 25.8
4 Other factors ¹	– 25.1	– 46.6
Total	+ 4.1	– 82.9
II Monetary policy operations of the Eurosystem		
1 Open market operations		
(a) Main refinancing operations	– 4.2	– 6.3
(b) Longer-term refinancing operations	– 4.5	+ 15.3
(c) Other operations	+ 105.2	+ 121.8
2 Standing facilities		
(a) Marginal lending facility	+ 0.0	– 0.1
(b) Deposit facility (increase: –)	– 47.0	– 14.1
Total	+ 49.5	+ 116.6
III Change in credit institutions' current accounts (I + II)	+ 53.8	+ 33.7
IV Change in the minimum reserve requirement (increase: –)	– 0.7	– 0.8

* 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.

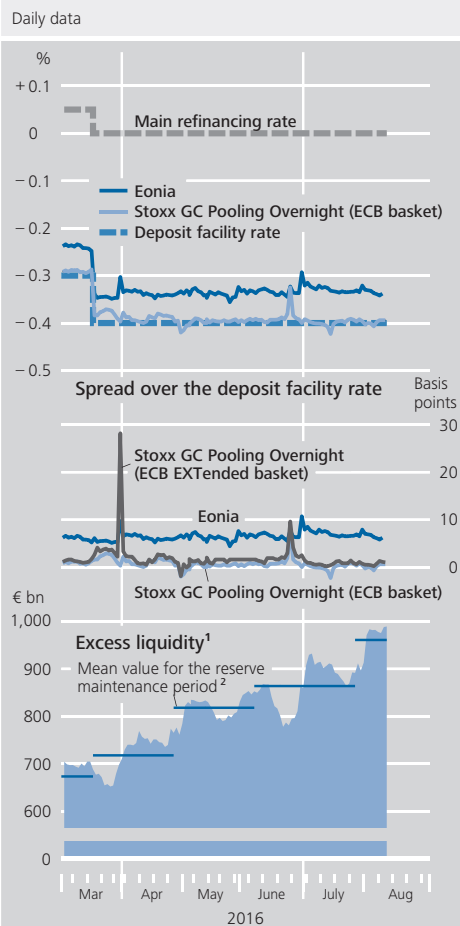
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anywhere between the main refinancing rate (0.00%) and the deposit rate (-0.40%), depending on the individual institution's net lending behaviour, demand stood at €399.3 billion (see the chart on page 28), placing it broadly at the lower end of market expectations. However, the voluntary repayments of the TLTRO I series which totalled €367.9 billion were also lower than assumed, accounting for 86.5% of the previously outstanding total amount of €425 billion. Considered together with the demand for the last TLTRO I, which stood at €6.7 billion, these operations still have an outstanding volume of €64 billion. Overall, on the value date the two allotments and the repayments of the TLTRO I series generated a net supply of liquidity in the amount of €38.2 billion. The size of regular refinancing operations continued to contract (see the chart on page 29). This caused demand for the main refinancing operations to fall to an average level of €47.6 billion in the June-July 2016 reserve period, down from €58.1 billion in the March-April 2016 reserve period; in a comparison of the two reserve periods, the refinancing volume resulting from the three-month tenders declined by €13.4 billion to an average of €24.5 billion.

The bulk of liquidity nevertheless continued to be provided via the Eurosystem's purchase programmes which boasted average balance sheet holdings of assets worth €1,227 billion in the June-July 2016 reserve period, of which €1,091 billion was attributable to the expanded asset purchase programme (APP) (see the adjacent table). This programme has now been broadened to include the corporate sector purchase programme (CSPP), with purchases of this kind commencing on 8 June 2016.

On balance, excess liquidity continued to rise, climbing to an average of €865 billion in the June-July 2016 reserve period, up by €147 billion on the average figure for the March-April 2016 period. As in the previous periods, there were also times during the

Central bank interest rates, money market rates and excess liquidity



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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Eurosystem purchase programmes

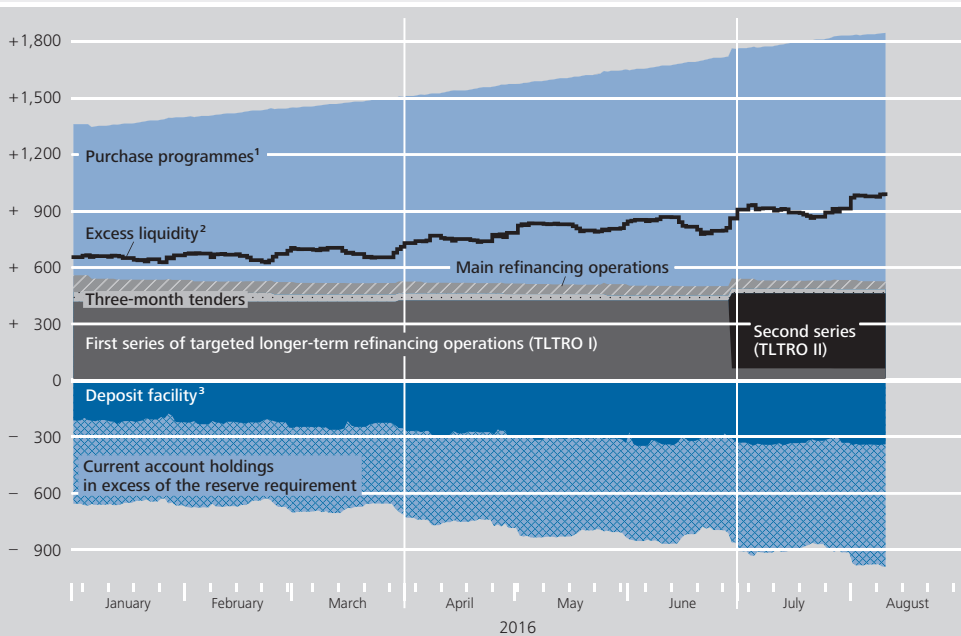
Item	Change across the two reserve periods	Balance sheet holdings as at 5 August 2016
Active programmes		
CSPP	+ 12.4	15.0
PSPP	+ 219.8	957.3
ABSPP	+ 1.2	20.4
CBPP3	+ 14.9	187.4
Completed programmes		
CBPP2	- 1.0	7.5
SMP	- 4.9	108.4
CBPP1	- 1.6	16.4

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period under review when excess liquidity proved rather volatile, primarily as a result of swings in the autonomous factors (not-

Liquidity provision and use

€ billion, daily data



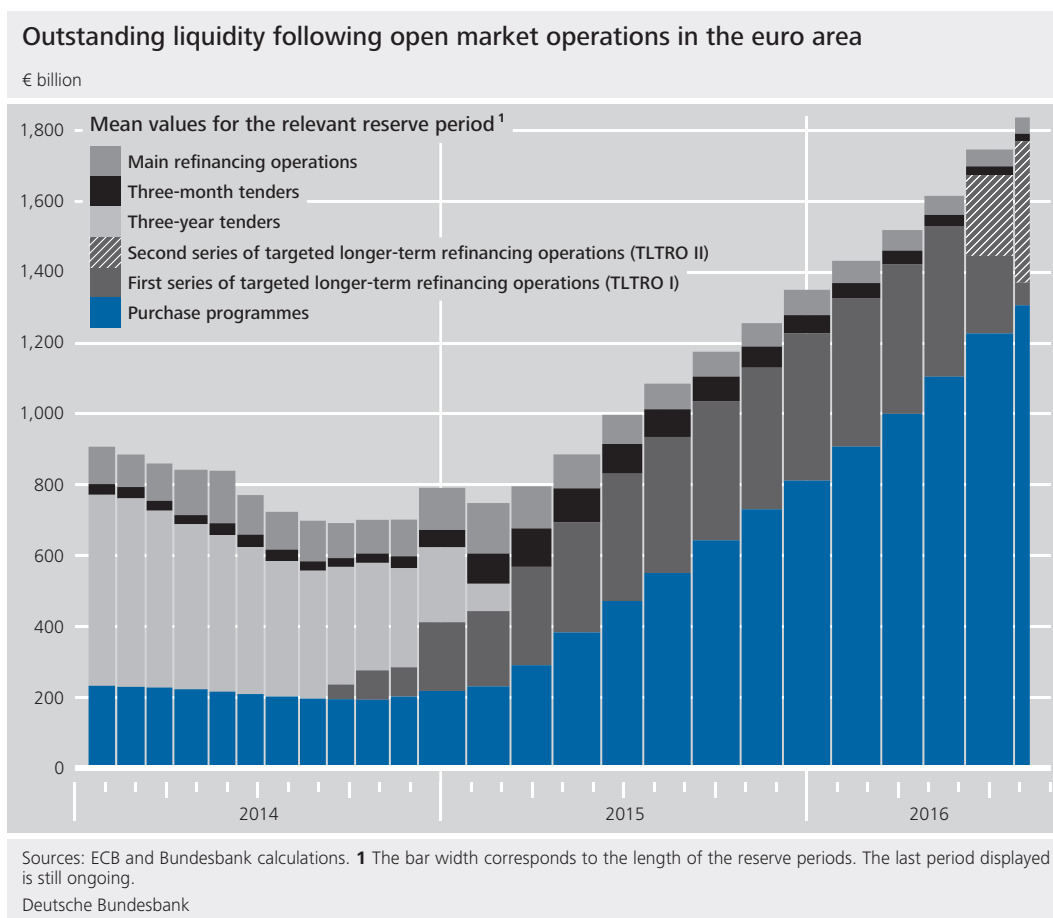
Sources: ECB and Bundesbank calculations. **1** Securities markets programme (SMP), covered bond purchase programmes (CBPP1, CBPP2 and CBPP3), asset-backed securities purchase programme (ABSPP), public sector purchase programme (PSPP) and corporate sector purchase programme (CSPP). **2** Current account holdings minus the minimum reserve requirement plus the deposit facility. **3** The marginal lending facility is not shown in this chart owing to its very low volume.

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ably government deposits with the Euro-system).

The abundant supply of liquidity meant that overnight rates remained geared to the rate on the deposit facility during both reserve periods under review (see the chart on page 27). Eonia continued to hover a few basis points above the deposit facility rate, recording an average level of -0.33% in the June-July 2016 reserve period (compared with -0.34% in the preceding period). By contrast, as a reference rate for secured overnight money, GC Pooling Overnight (ECB basket) averaged figures for the April-June 2016 reserve periods (a rounded -0.40%) and June-July 2016 (-0.39%) that were only marginally higher than the deposit facility rate; on some days, the interest rate even fell below this level (descending as low as -0.42%). Reasons cited for this dip include a certain focus on the securities provided as collateral as well as banks' internal rules. A similar pattern was displayed by secured overnight money in the ECB

EXTENDED basket (which contains a broader pool of collateral). This had an interest rate averaging around one basis point above the rate for the ECB basket in each of the two reserve periods. With regard to the three month-end rates within the observation period, overnight money rates were inconsistent for while Eonia went up, rates for both GC Pooling baskets generally went down on these dates. By contrast, tangible increases were evident on 24 June 2016, ie the day following the UK referendum on whether to leave the EU. However, these firmer rates (up to +7 basis points against the previous day in the ECB EXTENDED basket) proved to be only temporary. The underlying overnight turnover in both baskets and for Eonia remained at a low level throughout the period under review. The respective averages came to €11.0 billion (Eonia), €3.9 billion (ECB basket) and €5.2 billion (ECB EXTENDED basket) across the two reserve periods under consideration.



(TLTRO II) was conducted, as part of which 514 institutions borrowed an overall amount of €399.3 billion. Banks also had the option on this date to make early repayments of their outstanding volumes from the first seven TLTRO I operations. In all, a total of €367.9 billion in outstanding TLTRO I loans was repaid on this occasion. Taken together, the net liquidity effect of the repayments under the earlier TLTRO I operations, the eighth TLTRO I and the first TLTRO II thus came to €38.2 billion.

The ECB Governing Council decided in March 2016 to launch the TLTRO II series so as to reinforce its accommodative monetary policy stance and to further incentivise bank lending to the real economy. Counterparties are able to borrow in all TLTRO II operations a total amount of up to 30% of the credit volume outstanding to the non-financial private sector as at 31 January 2016 (excluding loans to households for house purchase), less any amount which was previously borrowed and is still out-

standing under the first two TLTRO I operations.¹ In line with market expectations, banks made only partial use of their overall borrowing allowances in the first TLTRO II operation. Given that TLTRO II operations all have the same maturity of four years, banks have an incentive to only make greater use of their borrowing allowances at a later point in time – a mechanism that would allow them to lock in the favourable funding conditions as far as possible into the future. In addition, expectations of a further cut in the deposit facility rate, which would also impact on the conditions of future TLTRO II operations, the very high and ever increasing volume of excess liquidity as well as the low borrowing costs in the market might have had a bearing on banks' bidding behaviour. The second operation in the TLTRO II series will be conducted in September of this year.

¹ For further information on the conditions and operational details of TLTRO II, see Deutsche Bundesbank, Monetary policy and banking business, Monthly Report, May 2016, pp 27-28.

Allocated borrowing allowances only partially exhausted

Purchase volumes still in line with target

On 5 August, the Eurosystem held assets in the amount of €957.3 billion as part of the public sector purchase programme (PSPP). The average residual maturity of the PSPP portfolio is currently eight years. The assets purchased to date under the third covered bond purchase programme (CBPP3) and the asset-backed securities purchase programme (ABSPP) came to €187.4 billion and €20.4 billion respectively.

In addition, the Eurosystem in June began implementing the corporate sector purchase programme (CSPP) agreed upon by the ECB Governing Council in March 2016. The volume of assets purchased under the CSPP came to €15 billion as at 5 August. In sum, the volume of assets purchased under the APP is thus in line with the targeted average monthly volume of €80 billion.²

Excess liquidity continues upward trend

APP purchases and slightly higher volumes in the other monetary policy operations drove excess liquidity up by around €143 billion in the reporting period, continuing the upward trend that excess liquidity has been following since the APP was launched. At last count, excess liquidity amounted to around €978 billion. Volumes are expected to continue rising throughout the rest of this year on the back of the monthly APP purchases.

Money market increasingly expecting another interest rate cut

With the ECB Governing Council leaving policy rates unchanged in the reporting period, the unsecured overnight money market rate (Eonia) hovered within a narrow corridor between -0.32% and -0.35% (except for the end of the first half of the year), remaining close to the deposit facility rate. The secured overnight rate (Stoxx GC Pooling) ranged between -0.325% and -0.423%. At the same time, three-month Euribor continued its downward trend, dipping to an all-time low of -0.298% as this report went to press. This narrowed the spread over the overnight rate to as little as just over three basis points in a reflection of increased expectations that the deposit facility rate might be cut before the end of 2016. These expectations were given another boost following the unex-

pected outcome (for the markets) of the UK referendum on membership of the European Union and the economic uncertainty it sparked. Money market forward rates, especially those for longer maturities, likewise eased substantially for a time but much of the decline has unwound since then. Fluctuations in money market forward rates are thus a reflection of prevailing uncertainty and make it necessary to exercise caution when interpreting rates in terms of what they say about expectations of rate cuts.

Monetary developments in the euro area

In the months between April and June 2016, the broad monetary aggregate M3 continued to expand markedly, albeit at a noticeably slower pace than in the first quarter. A key factor driving monetary growth was once again the ongoing accumulation of overnight deposits by the money-holding sector amidst a further decline in opportunity costs for that form of deposit. As for the counterparts of M3, the recovery of loans to the non-financial private sector, which had already been observed in the preceding quarters, persisted into the second quarter. Simultaneously, MFIs considerably increased their securities-based lending to the non-financial private sector. Moreover, as in the previous quarters, monetary growth was supported by a strong increase in MFIs' securities-based lending to general government, which was fuelled to a large extent by the Eurosystem's asset purchases. However, the positive effects of these drivers were again partially offset by steady outflows of funds from the euro area, a development that was likewise associated with the Eurosystem's monetary policy measures.

Monetary growth still strongly affected by monetary policy stance

² As in the previous year, part of the planned purchase volume for this month was brought forward ("frontloaded") due to the typical lull in market activity in August; where necessary, subsequent purchases will be adjusted so that the targeted monthly volume of purchases under the APP averages €80 billion despite a smaller volume of assets being purchased in August.

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

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

Assets	2016 Q2	2016 Q1	Liabilities	2016 Q2	2016 Q1
Credit to private non-MFIs in the euro area	52.4	67.4	Central government deposits	4.3	40.1
Loans	14.9	84.2	Monetary aggregate M3	108.4	175.4
Loans, adjusted ¹	50.7	53.6	of which Components		
Securities	37.5	- 16.7	Currency in circulation and overnight deposits (M1)	94.0	173.1
Credit to general government in the euro area	127.9	123.1	Other shorter-term bank deposits (M2-M1)	- 3.7	- 13.7
Loans	- 8.0	2.7	Marketable instruments (M3-M2)	18.1	16.1
Securities	135.9	120.4	MFI longer-term financial liabilities	- 12.0	- 62.4
Net external assets	- 61.6	- 70.4	of which		
Other counterparts of M3	- 18.0	33.0	Capital and reserves	24.1	- 10.9
			Other longer-term financial liabilities	- 36.2	- 51.4

* Adjusted for statistical changes and revaluations. ¹ Adjusted for loan sales and securitisation as well as for positions arising from notional cash pooling services provided by MFIs.

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Hence, monetary developments continue to be dictated to a substantial extent by monetary policy. Overall, at 5.0%, the annual growth rate of M3 remained virtually unchanged on the quarter and thus continued the sideways movement observed since mid-2015.

In terms of monetary counterparts, lending to the money-holding sector in the euro area was yet again a crucial source of monetary growth in the reporting quarter. Loans to private non-MFIs adjusted for securitisation and other one-off effects grew by roughly the same amount in the reporting quarter as in the preceding quarter. The striking and much more pronounced discrepancy (compared with previous periods) between the unadjusted and adjusted loan figures (see the table above) is attributable to the fact that, since June of this year, the ECB has also been adjusting loans to the euro-area private sector for positions arising from notional cash pooling services provided by MFIs, retrospectively as from December 2014. This eliminates the distorting impact of the one-off effect in the Netherlands described in our February and May 2016 *Monthly Reports*.³

Loans to domestic private sector now adjusted for notional cash pooling services

M3 growth continues to be driven by increase in overnight deposits

M3 growth in the reporting quarter was again driven by the persistent considerable increase in overnight deposits observed since mid-2012; once more, both households and non-financial corporations built up overnight deposits substantially. The consistently strong demand in the non-financial private sector for this highly liquid monetary component can be explained by the interest rate environment, amongst other things. For example, the opportunity cost of holding money, measured as the spread between ten-year government bond yields and short-term money market rates, fell yet again in the second quarter. In addition, the narrowing interest rate spreads between overnight deposits and other short-term deposits (the latter encompassing short-term time and savings deposits) created a favourable setting for shifts within M3 into overnight deposits. As a result, households and non-financial corporations further reduced their holdings of other short-term deposits in the reporting quarter.

Adjusted in the same way, loans to the domestic non-financial private sector, too, continued to increase against the backdrop of historically low interest rates and the persistently positive underlying trend shown by the euro-area economy. With regard to loans to non-financial corporations, the upward tendency exhibited by

Marked rise in loans to non-financial corporations

³ For details, see ECB, Explanatory note on adjusted loans series, 27 July 2016; and A Colangelo, The statistical classification of cash pooling activities, Statistics Paper Series, ECB, No 16/July 2016.

Monetary aggregates and counterparts in the euro area

Year-on-year percentage growth rate; growth contributions in percentage points; end-of-quarter data; seasonally adjusted



Source: ECB. **1** Denoted with a negative sign because, per se, an increase curbs M3 growth. **2** Adjusted for loan sales and securitisation as well as for positions arising from notional cash pooling services provided by MFIs. **3** Non-monetary financial corporations.

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net inflows since the second half of 2013 continued on the whole, although the quarterly figure in the reporting quarter fell short of the unusually strong rise seen in the previous quarter. On balance, increases were recorded across all maturity categories. Hence, the annual growth rate of loans to non-financial corporations continued to rise, but remained subdued at 1.7% at the end of June.

According to the results of the Bank Lending Survey (BLS) for the second quarter, the expansion in lending was supported by banks' lending policy and by the mounting financing needs of enterprises. The euro-area bank managers responding to the BLS reported a slight easing, on balance, of standards for loans to enterprises. At the same time, demand for bank loans on the part of non-financial corporations went up markedly in the second quarter. Survey participants mainly put this increase down to the low general level of interest rates and to businesses' financing needs for adjustments to corporate structures, inventories and working capital as well as for debt refinancing and restructuring.

Ongoing recovery in non-financial corporations' credit demand

Broken down by country, many of the loans to non-financial corporations originated as hitherto from credit institutions domiciled in the two largest member states (see the chart on page 33). Loans issued by French banks to French enterprises gained even more momentum against the backdrop of recovering economic activity in France, while the reporting quarter saw German credit institutions further expanding their lending operations, above all the volume of credit granted to non-financial corporations in the other core euro-area countries. This stands in contrast with the perceptible quarter-on-quarter decline in the volume of German bank loans to German enterprises. In Italy, the perceptible upward trajectory followed by loans over the past few quarters remained intact, albeit at a very low level, while lending in Spain recorded a slight increase during the quarter under review.

Discernible country-specific differences in loan dynamics

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

Growth in loans to euro-area households accelerated somewhat in the second quarter of 2016, but the annual rate of expansion in this segment remained at a moderate 1.7% at the end of the reporting quarter. The main drivers of this growth, particularly in Germany and France, were once again loans for house purchase. Periphery countries, where the need for households to deleverage has declined – at times appreciably – in recent years, saw households run down their loans for house purchase at a slower pace. For the euro area as a whole, the banks responding to the BLS again reported on brisk household demand for loans for house purchase in the second quarter. According to the bank managers surveyed, demand was mainly buoyed by the low general level of interest rates, consumer confidence, the outlook on the housing market and by anticipated changes in residential property prices. Credit standards in this segment were eased marginally in net terms.

Consumer credit still growing in many countries

Consumer credit remained unchanged on balance in the reporting quarter, but that was because of securitisation transactions in France;⁴ in many other member states, the growth in consumer credit observed in recent quarters continued, most likely as a reflection of the ongoing underlying strength of private consumption growth in the euro area. This view is consistent with the renewed rise in demand for consumer credit indicated by the BLS, which respondents primarily put down to consumers' buoyant spending habits, the low general level of interest rates and the ongoing robustness of consumer confidence. Credit standards in this segment were eased somewhat.

Eurosystem government bond purchases still a major driver of monetary growth, ...

In addition to granting loans, the MFI sector considerably expanded its securities-based lending to the private sector as well in the quarter under review. However, the strong growth in securities-based lending to general government, in which the Eurosystem's government bond purchases under the PSPP play a major role, once again made this counterpart the strongest contributor to monetary growth.

Loans to non-financial corporations in the euro area*

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



Sources: ECB and Bundesbank calculations. * Loans adjusted for loan sales and securitisation. ¹ Additionally adjusted for positions arising from notional cash pooling services provided by MFIs.

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Since Eurosystem purchases of assets from commercial banks' portfolios do not affect the MFI sector's consolidated balance sheet, the continued rise in this counterpart suggests that a sizeable share of the monetary policy-related purchases of government bonds continued to be from holders outside the domestic banking sector.

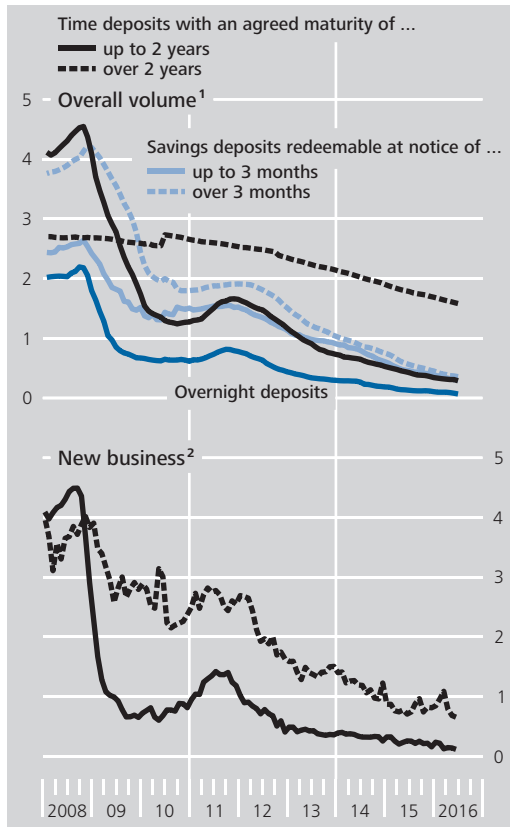
On balance, however, the impact of the PSPP on the monetary aggregate is not as pronounced as the increase in securities-based lending to general government would imply, as the purchase programme at the same time gives rise to outflows of funds from the euro area to non-residents. These outflows in turn reduce the MFI sector's net external assets, thus curbing M3 growth (see the chart on page 32). For example, the data currently available for the months of April and May indicate

... but they also spurred portfolio investment outflows

⁴ At the consumer credit level, the ECB does not adjust reported loan figures for loan sales and securitisation.

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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that during the reporting quarter, non-resident investors once again offloaded fairly large volumes of government bonds issued in the euro area and, on a smaller scale, bonds of the private non-bank sector as well. In addition, domestic non-banks' ongoing demand for non-resident debt securities triggered portfolio investment outflows. Overall, then, domestic securities are being substituted with foreign instruments.

Monetary developments were also fuelled by perceptible outflows from longer-term financial liabilities, albeit on a much smaller scale than in previous quarters. This decline was mainly

Fresh outflows from longer-term financial liabilities

attributable to outflows from long-term time and savings deposits and benefited from the pattern of interest rates. However, the money-holding sector also reduced the stock of long-term bank debt securities in its portfolio.

German banks' deposit and lending business with domestic customers

Growth in the deposit business of Germany's banks was less vibrant in the reporting quarter than it had been in the first quarter of 2016. The underlying investment behaviour of non-banks remained unchanged, however, and continued to see an ongoing increase in short-term deposits and a simultaneous reduction in long-term deposits. Significant inflows were once again recorded by overnight deposits, especially those of households and non-financial corporations. This should be viewed, as before, in conjunction with the historically narrow yield premium offered by alternative, less flexible bank deposits (see the adjacent chart).

At the sector level, households once again contributed most to the current growth in short-term bank deposits. Households not only further built up their overnight deposits but – for the first time in eight quarters – also boosted their short-term time deposits once more, albeit on a much smaller scale. Non-financial corporations, too, lifted their overnight deposits again distinctly, but noticeably reduced their other bank deposits at the same time. The non-financial private sector's keen interest in highly liquid bank deposits was probably also stimulated further in the quarter under review by high levels of disposable household income and non-financial corporations' strong earnings position.

Unlike the non-financial private sector, financial corporations further reduced their bank deposits on balance. As in the previous quarters, investment behaviour in this sector is likely to

Deposit growth in low-interest-rate environment still dominated by build-up of overnight deposits ...

... and driven by the non-financial private sector

Deposit business with financial corporations still characterised by search for yield

have been shaped by shifts into higher-yielding assets.⁵ In addition, the public sector also scaled back its stock of deposits held with domestic banks markedly in net terms, although this reduction – unlike in the other sectors – applied exclusively to short-term deposits.

Distinct increase in lending business with domestic non-banks on balance

Banks' lending business with the domestic non-bank sector continued to rise in the reporting quarter. As in the previous quarters, this growth was driven solely by the increase in lending to private non-banks, with banks not only granting loans to the private sector but also raising their holdings of privately issued securities, which they had reduced – in some cases markedly – in the preceding quarters. This increase is possibly associated with the CSPP which started being implemented in June, following its announcement in March. At the same time, German banks reported a decline in lending business with the domestic public sector that affected both securitised lending and loans. This is likely to reflect, not least, the low financing needs given the favourable state of public finances (see details of developments in public finances on pages 59 to 77).

Loans to the private sector still driven by loans for house purchase

As previously, loans to households made up the bulk of loans to the private sector. This was primarily down to the continued vibrant household demand for loans for house purchase, which picked up again slightly in the quarter under review and was bolstered by the exceptionally low level of interest rates. During the reporting quarter, for example, the interest rate on long-term loans for house purchase saw another marginal decline to stand at 1.8% at the end of the quarter.

Other reasons for this are provided by the latest BLS results, which suggest that, apart from the low interest rates, household demand for loans for house purchase was also buoyed by stable consumer confidence, the upbeat outlook for the housing market and developments in residential property prices. The institutions taking part in the survey reported on three factors that were dampening financing requirements:

Lending and deposits of monetary financial institutions in Germany[†]

Changes in € billion, seasonally adjusted

Item	2016	
	Q1	Q2
Deposits of domestic non-MFIs ¹		
Overnight	37.2	26.6
With an agreed maturity of		
up to 2 years	1.9	-1.8
over 2 years	-2.5	-2.9
Redeemable at notice of		
up to 3 months	2.2	0.8
over 3 months	-3.6	-2.1
Lending		
to domestic general government		
Loans	2.2	-3.2
Securities	-4.3	-7.8
to domestic enterprises and households		
Loans ²	20.5	15.2
of which to households ³	11.2	11.3
to non-financial corporations ⁴	8.2	0.3
Securities	-8.7	12.2

* 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.

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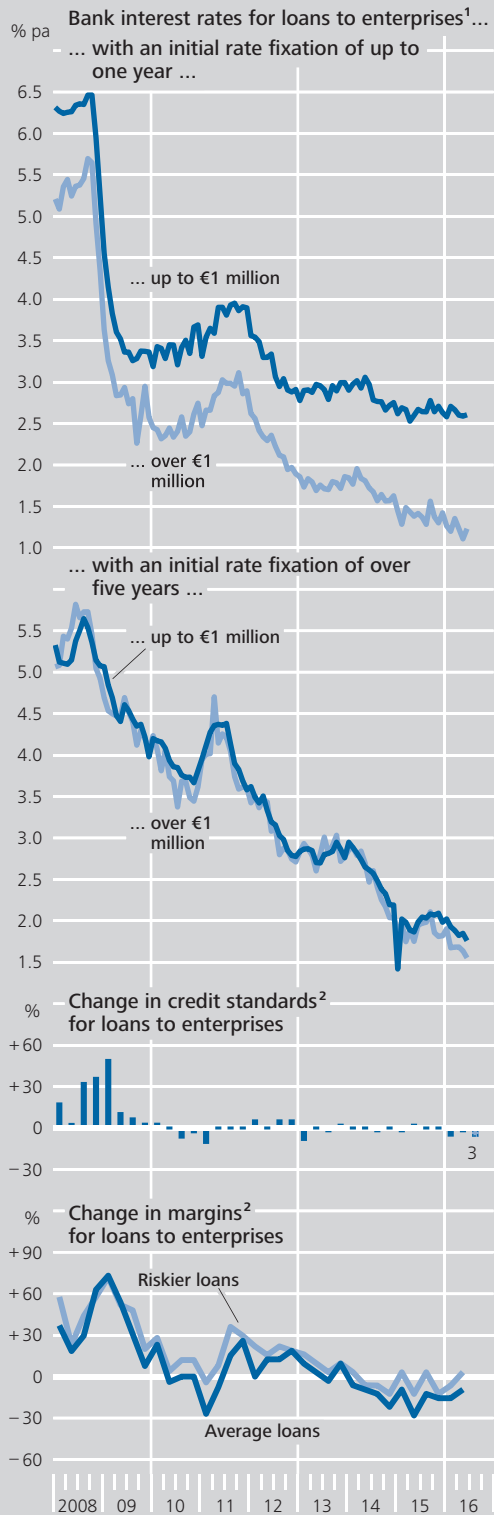
households drawing on their own funds; draw-downs of loans from other banks; and the entry into force in March 2016 of the Act Implementing the Mortgage Credit Directive and Amending Accounting Rules (*Gesetz zur Umsetzung der Wohnimmobilienkreditrichtlinie und zur Änderung handelsrechtlicher Vorschriften*). The banks also cited this Act as the main reason for once again tightening their credit standards, on balance, in the reporting quarter.

Judging by the BLS results, the surveyed banks did not ease their minimum credit standards for potential borrowers and thus did not assume higher risks for lending in the reporting quarter. Bearing this in mind, the favourable general climate – the high levels of households' financial assets, stable incomes and, not least, the lack of attractive alternative investment op-

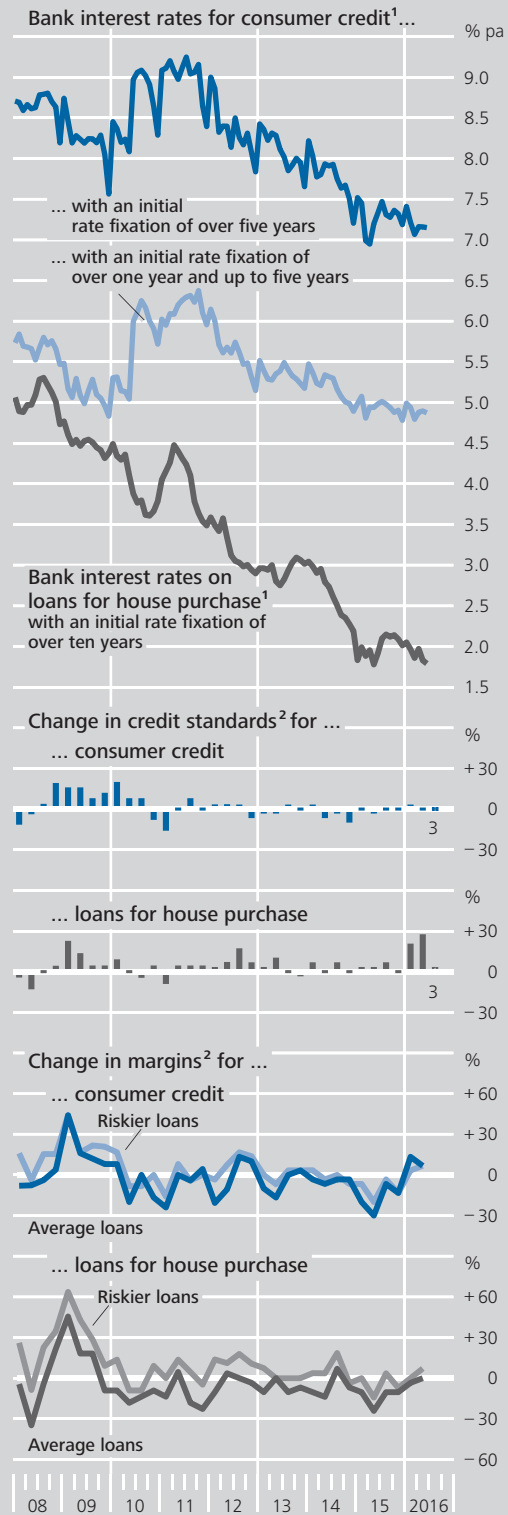
⁵ See Deutsche Bundesbank, Indications of portfolio shifts into higher-yielding assets in Germany, Monthly Report, May 2016, pp 34-37.

Banking conditions in Germany

Credit to non-financial corporations



Credit to households



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 Q3.

tions – more households with a solid financial background would suggest that showed an interest in taking out loans, meaning that banks were ultimately able to step up their lending. Overall, growth in mortgage lending to households during the reporting quarter came in at an annualised rate of 3.8% at the end of the quarter and is thus still distinctly short of the long-term average of just under 5% recorded since the beginning of the 1980s.

Perceptible rise in consumer credit

Noticeable inflows were likewise recorded in consumer credit to households in the quarter under review. This is consistent with the considerable rise in demand for consumer credit in the reporting quarter observed by BLS respondents. The surveyed institutions identified consumers' stronger spending habits, the high level of consumer confidence and the low general level of interest rates as the main drivers of this increased demand. The respondent banks did not change their lending policies in this segment.

Lending to non-financial corporations moving sideways

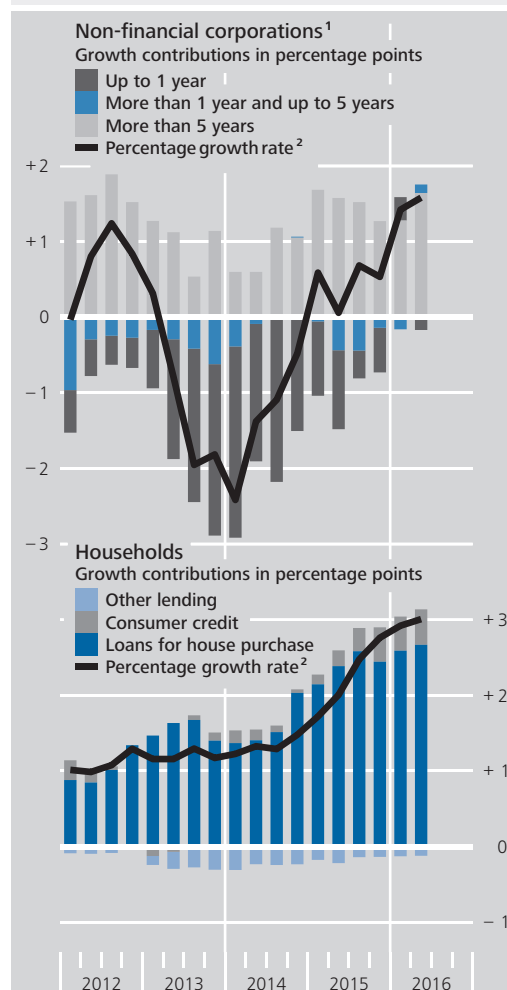
By contrast, the volume of loans which German banks extended to domestic non-financial corporations remained virtually unchanged in the quarter under review, after having expanded – in some cases markedly – in the preceding quarters. Lending activity was weak in the second quarter on account of a significant decline in short-term loans which nonetheless continued to be highly volatile. Long-term loans, on the other hand, saw another distinct rise in the reporting quarter.

Credit standards for enterprises virtually unchanged

German banks participating in the BLS painted a slightly more upbeat picture of enterprises' demand for loans, which they said had increased slightly in the second quarter of 2016 while credit standards remained unchanged. The banks surveyed saw the financing needs for debt restructuring, refinancing and renegotiations as well as the low general level of interest rates as major factors shoring up demand. For example, at the end of June, domestic enterprises paid interest amounting to 2.6% for small-volume and 1.2% for large-volume loans

Loans by German banks to the domestic non-financial private sector

Seasonally adjusted and adjusted for loan sales and securitisation; end-of-quarter data



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

in the short-term segment, while interest on long-term loans stood at 1.8% and 1.6% respectively of late. On the other hand, the BLS revealed that demand was being dampened *ceteris paribus* by enterprises' ability to fall back on alternative sources of funding in the shape of ample internal financing options or loans provided by other banks.

And internal financing has indeed grown steadily in importance in recent years on account of German enterprises' strong profitability and stable investment income, keeping firms' demand for bank loans comparatively low. In addition, other external sources of funding,

such as loans to group affiliates, trade credits and loans from shadow banks, are increasingly gaining in significance, narrowing the share of bank loans in companies' more broadly diversified funding portfolios further still.

More banks interested in future TLTRO II operations

The BLS conducted in the second quarter of 2016 contained ad hoc questions on participating banks' financing conditions, on the impact of the new regulatory and supervisory activities (including the capital adequacy requirements defined in CRR/CRDIV), as well as the banks' participation in the targeted longer-term refinancing operations (TLTRO I and TLTRO II). German banks once again reported a marginal quarter-on-quarter improvement in their funding situation in the context of the situation on the financial markets. As for the new regulatory

and supervisory activities, the first half of 2016 saw the banks further reducing their risk-weighted assets on balance and significantly strengthening their capital position. The surveyed banks showed only slightly more interest in the first TLTRO II operation in June 2016 than they had done in the earlier TLTROs. Significantly more banks are generally interested in the future TLTRO II operations, however, citing the operations' attractive conditions as the reason for their participation or interest. Respondents reported that they would use the borrowed funds chiefly for lending, in line with the operations' objective. All in all, the TLTROs to date had slightly improved the participating banks' financial situation, but reportedly hardly affected their credit standards.