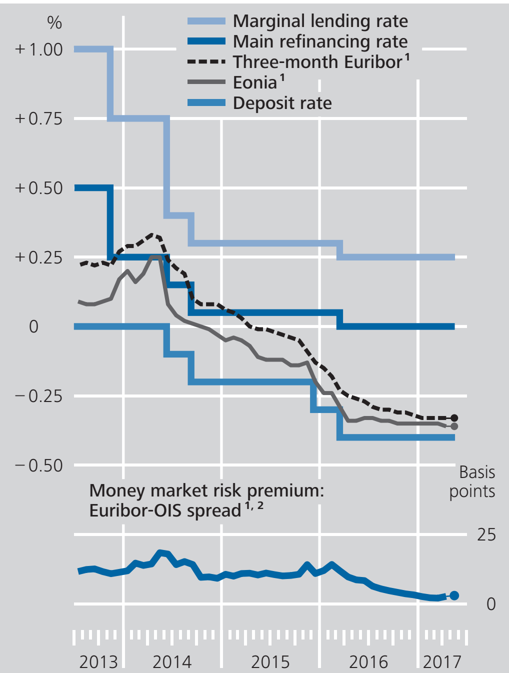
Monetary policy and banking business

Monetary policy and money market developments

ECB Governing Council leaves policy rates unchanged

The Governing Council of the European Central Bank (ECB) kept the key interest rates unchanged in the reporting period. The main refinancing rate therefore remains at 0%, while the marginal lending rate stands at 0.25% and the deposit facility rate at -0.40%. Furthermore, 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. Purchases under the expanded asset purchase programme (APP) have been made at the reduced monthly pace of €60 billion since April 2017 and will run until the end of December 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 inflation aim. The net purchases will be made alongside reinvestments of the principal payments from maturing securities purchased under the APP.

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 18 May 2017.
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Economic recovery increasingly taking hold and downside risks diminished

The economic recovery in the euro area has become increasingly solid in recent quarters, according to the ECB Governing Council's assessment. At the same time, the downside risks to the euro area's growth prospects waned, meaning that the risks are moving towards a more balanced configuration overall. However, the Governing Council perceives that the risks have so far remained tilted to the downside and relate predominantly to global factors. The ECB Governing Council will review this assessment at the beginning of June, when the new Eurosystem macroeconomic projections are available.

Headline inflation up significantly on 2016

The Governing Council of the ECB does not consider the significant rise in the headline inflation rate to close to 2% at present to be durable and self-sustained, noting that pressure on core inflation has remained subdued and has yet to show a convincing upward trend. The Governing Council therefore believes that a very substantial degree of monetary accommodation is still needed for underlying inflation pressures to build up and support headline inflation in the medium term. In view of the recently observed fluctuations in headline inflation, the ECB Governing Council also stressed the need to continue to look through changes in HICP inflation that it judges to be transient and to have no implication for the medium-term outlook for price stability.

474 banks borrow €233.5 billion in final TLTRO II

On 29 March 2017, the last of the total of four rounds in the second series of targeted longer-term refinancing operations (TLTRO II) adopted in March 2016 was conducted. This operation saw 474 institutions taking up an overall volume of €233.5 billion. This significantly exceeded market expectations, probably thanks

Money market management and liquidity needs

The two reserve maintenance periods between 25 January 2017 and 2 May 2017 saw a significant increase in euro-area liquidity needs stemming from autonomous factors (see the table below). They averaged €1,000.5 billion in the March-May 2017 reserve period, which was €99.5 billion more than the average for the December 2016-January 2017 reserve period, ie the last period before the period under observation. Overall, the sum of the autonomous factors moved within a broad corridor of €890.0 billion to €1,038.8 billion in the two reserve maintenance periods and exceeded the €1 trillion mark for the first time. The average increase in autonomous factors resulted mainly from the €61.3 billion decline in net foreign assets and other factors, which are considered together because of liquidity-neutral valuation effects. In addition, the increase in government deposits with the Eurosystem also raised the calculated need for central bank liquidity by an average of €38.9 billion. In the March-May 2017 reserve period, average deposits were therefore high, at €182.0 billion. Banknotes in circulation, which fell slightly by €0.7 billion in net terms, had little influence on the banking sector's liquidity position vis-à-vis the Eurosystem. The minimum reserve requirement was €120.6 billion in the March-May 2017 reserve period, which equated to a liquidity-absorbing increase totalling €1.9 billion across the two reserve maintenance periods.

A particularly important event during the period under observation was the allotment of the fourth operation in the second series of targeted longer-term refinancing oper-

Factors determining banks' liquidity*

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

Item	2017 25 January to 14 March	2017 15 March to 2 May
I Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors		
1 Banknotes in circulation (increase: –)	+ 8.3	– 7.6
2 Government deposits with the Eurosystem (increase: –)	– 17.2	– 21.7
3 Net foreign assets[1]	– 12.3	+ 16.2
4 Other factors[1]	– 8.6	– 56.6
Total	– 29.8	– 69.7
II Monetary policy operations of the Eurosystem		
1 Open market operations		
(a) Main refinancing operations	– 5.6	– 10.5
(b) Longer-term refinancing operations	+ 5.4	+ 153.1
(c) Other operations	+ 116.7	+ 117.8
2 Standing facilities		
(a) Marginal lending facility	+ 0.1	+ 0.0
(b) Deposit facility (increase: –)	– 44.8	– 70.8
Total	+ 71.8	+ 189.6
III Change in credit institutions' current accounts (I + II)	+ 41.9	+ 120.2
IV Change in the minimum reserve requirement (increase: –)	– 1.6	– 0.3

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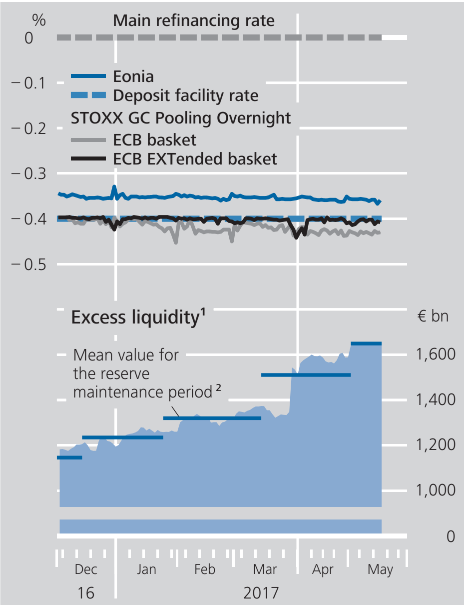
Central bank interest rates, money market rates and excess liquidity

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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Eurosystem purchase programmes

€ billion

Item	Change across the two reserve periods	Balance sheet holdings as at 12 May 2017
Active programmes		
PSPP	+ 203.9	1,534.8
CBPP3	+ 9.2	218.6
CSPP	+ 24.8	84.9
ABSPP	+ 0.9	23.8
Completed programmes		
SMP	− 3.8	98.4
CBPP1	− 2.8	8.3
CBPP2	− 1.0	5.8

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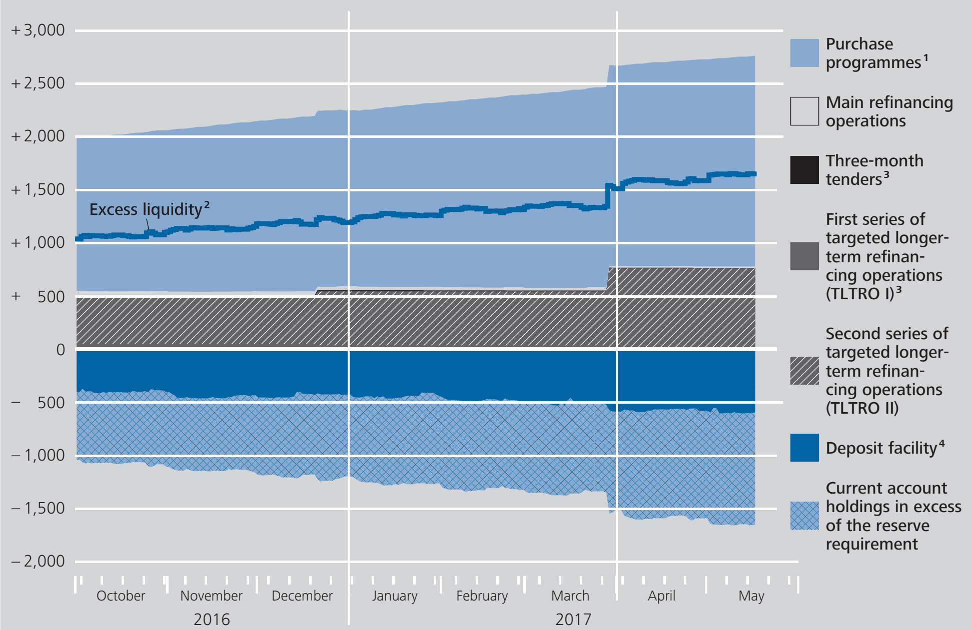
ations (TLTRO II). Overall, 474 credit institutions were allotted €233.5 billion, which was significantly more than the majority of market participants had expected beforehand. The attractive terms for this four-year operation and the prospect that this tender was, for now, the last of its kind are likely to have been key factors contributing to the high demand. In addition to this TLTRO II operation, voluntary early repayments of the first and third operations of the TLTRO I series totalling €16.7 billion were received on 29 March 2017, meaning that the net injection of liquidity from these three operations amounted to €216.7 billion overall. The positive liquidity effects had been considerably lower for the three previous TLTRO II operations, namely €38.2 billion, €34.2 billion and €48.0 billion. The volume of all TLTRO II operations totalled €740.2 billion at the end of the period under review, which was equal to 95% of the outstanding tender volume.

This dominance of long-term operations came at the expense of standard tenders: averaged across the March-May 2017 reserve period, demand for the main refinancing operations dropped by €16.1 billion to €18.5 billion as compared to the December 2016-January 2017 reserve period. Moreover, the total volume of the three-month tenders fell by €4.3 billion to €7.4 billion in the same period. In sum, the outstanding tender volume rose considerably, however, and averaged €725.9 billion in the March-May 2017 reserve period (+€142.4 billion compared with the average for the December 2016-January 2017 reserve period; see the charts on pages 25 and 26).

Despite this increase, monetary policy asset purchase programmes again accounted for the majority of the liquidity provided through the Eurosystem in the period under consideration. During the March-May 2017 reserve period, they represented average balance sheet holdings of €1,905 billion, which equated to a plus of €234 billion relative to the average balance sheet holdings of all purchase programmes in the December 2016-January 2017 reserve period (see the adjacent table). As of 1 April 2017, the Eurosystem reduced its intended monthly purchase volume under the ex-

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** Volume so small it is hardly visible. **4** The marginal lending facility is not shown in this chart owing to its very low volume.

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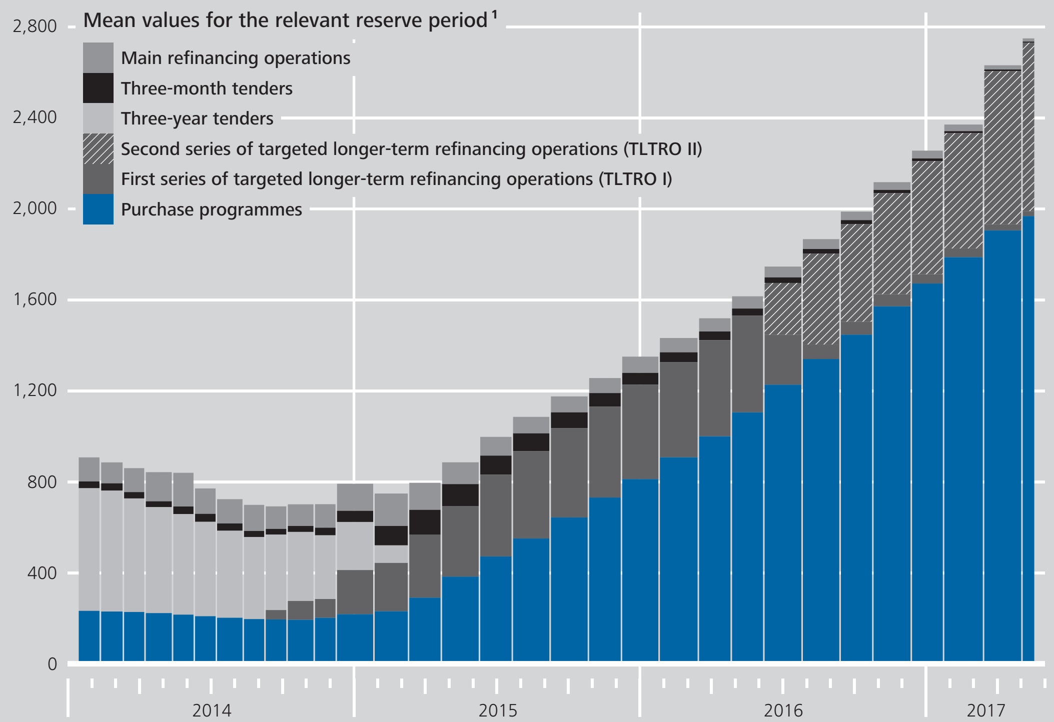
panded asset purchase programme (APP) from €80 billion to €60 billion.

As a result, excess liquidity in the Eurosystem rose further during the reporting period. During the March-May 2017 reserve period, it averaged €1,510 billion, which was €276 billion above the average of the December 2016-January 2017 reserve period. The greater liquidity needs resulting from autonomous factors, however, meant that the injection of liquidity from open market operations was not fully reflected in excess liquidity. Nonetheless, excess liquidity reached a new all-time high of €1,641 billion on the last day of the observation period.

This extremely comfortable liquidity situation meant that the deposit facility rate remained the benchmark for overnight rates during the period under review (see the chart on page 24). Eonia stayed above the deposit rate and tended to move between -0.35% and -0.36% throughout the two reserve maintenance periods, albeit with low turnovers averaging €9.2 billion (as compared to €13.8 billion in the two corresponding periods of the previous year). By contrast, secured overnight money in GC Pooling (ECB basket) was even trading somewhat below the deposit rate in the period under review, at an average of -0.42%, with regulatory factors potentially also having an influence. Overnight money in the ECB EXTended basket (which contains a larger set of eligible securities) traded at an average of -0.40%. The underlying GC Pooling Overnight turnovers in the two baskets were also low during the two reserve maintenance periods, at a total of €5.6 billion on average (compared with €10.0 billion in the same two periods of the previous year). End-of-month transactions have recently not tended to have any major impact on Eonia or the overnight rates in GC Pooling.

Outstanding liquidity broken down by open market operations in the euro area

€ billion



Sources: ECB and Bundesbank calculations. **1** The bar width corresponds to the length of the reserve periods. The last period displayed is still ongoing.
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to the operation's favourable conditions, which became even more attractive compared with the costs of market-based funding due to growing expectations of an interest rate hike. In parallel to the final TLTRO II allotment, there were voluntary repayments of funds provided under the first series of targeted longer-term refinancing operations (TLTRO I) in the total amount of €16.7 billion. This brought the net liquidity effect to €216.8 billion. The total amount outstanding for TLTRO I and II is thus €762 billion.

Purchase volumes still in line with announced target

On 12 May 2017, the Eurosystem held assets in the amount of €1,534.8 billion as part of the public sector purchase programme (PSPP). The average residual maturity of the PSPP portfolio declined again slightly from 8.3 years to 8 years. Assets purchased to date under the third covered bond purchase programme (CBPP3) and the asset-backed securities purchase programme (ABSPP) came to €218.6 billion and €23.8 billion, respectively. As for the corporate sector purchase programme (CSPP), the volume of assets purchased up to 12 May totalled €84.9 billion.

Excess liquidity continues upward trend

In the period under review, excess liquidity continued to follow the upward trend seen since the APP was launched, climbing by €329 billion to €1,654 billion. This increase was again mainly propelled in the reporting period by the continued asset purchases and given a further boost by the positive net liquidity effect stemming from the TLTROs, while volumes in the standard tender operations eased again slightly. Excess liquidity should carry on increasing throughout the rest of this year on account of the monthly APP purchases.

Fluctuating forward rates signal uncertainty about interest expectations

The unsecured overnight rate in the money market (Eonia) hovered in a narrow range of between -0.35% and -0.36% during the period under review, which was not far off the deposit facility rate, while the secured overnight rate (STOXX GC Pooling) was still lower than the

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

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

Assets	2017 Q1	2016 Q4	Liabilities	2017 Q1	2016 Q4
Credit to private non-MFIs in the euro area	152.6	79.8	Central government deposits	– 15.9	6.6
Loans	99.6	61.4	Monetary aggregate M3	212.8	117.7
Loans, adjusted 1	92.9	65.0	*of which* Components		
Securities	53.0	18.3	Currency in circulation and overnight deposits (M1)	202.0	162.6
Credit to general government in the euro area	61.0	153.1	Other shorter-term bank deposits (M2-M1)	– 7.2	– 62.1
Loans	– 11.0	– 20.3	Marketable instruments (M3-M2)	18.0	17.2
Securities	71.2	173.6	MFI longer-term financial liabilities	– 26.3	– 27.5
Net external assets	– 30.4	– 44.5	*of which* Capital and reserves	28.1	15.0
Other counterparts of M3	– 11.9	– 91.7	Other longer-term financial liabilities	– 54.4	– 42.6

***** 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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Eonia rate and slightly below, but close to, the deposit facility rate. The three-month Euribor was largely unchanged in the reporting period, standing at -0.33% at last report. Money market forward rates experienced strong fluctuations in the period under review, signalling uncertainty in the assessments concerning the future path of key monetary policy rates. In March, forward rates rose distinctly, indicating a market expectation of a possible first hike to the deposit facility rate as early as the beginning of 2018. More recently, however, they exhibited signs that the deposit facility rate is expected to be lifted only after the end of 2018 or thereabouts.

Monetary developments in the euro area

Accommodative monetary policy shapes monetary dynamics

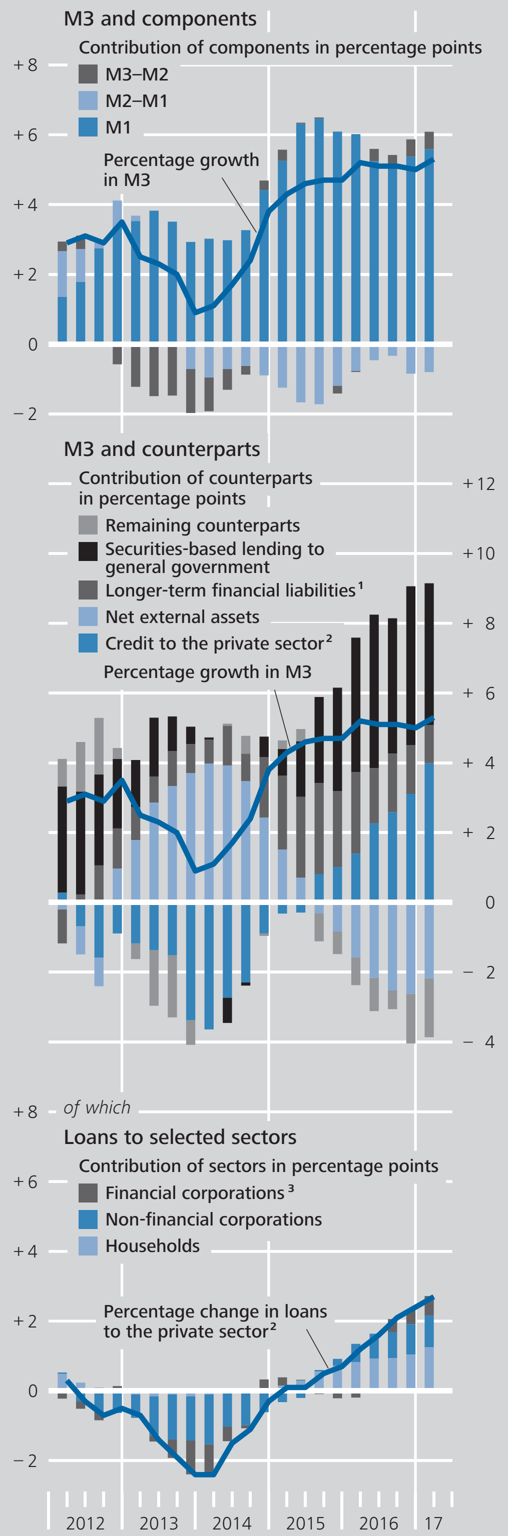
The broad monetary aggregate M3 continued to grow considerably in the first quarter of 2017, the annual growth rate of 5.3% observed at the end of March matching the pace recorded since back in April 2015. The sustained expansion of the money stock can be explained by the money-holding sector's ongoing strong preference for overnight deposits given low opportunity costs. A glance at the counterparts reveals that lending by the MFI sector – including the Eurosystem – to non-banks in the euro area was the chief driver of monetary growth in the last few quarters. During the quarter under review, continued growth was seen mainly in bank loans to the private sector, on account of the economy's robust and geographically broad growth path as well as the very low interest rate level. At the same time, securitised lending to the non-bank private sector and general government also continued to grow on the back of the Eurosystem's asset purchases.

Overnight deposits still main driver of M3 growth

The increase in overnight deposits has been the dominant factor in monetary growth for five consecutive years now; inflows were particularly strong between January and March 2017. For the most part, the deposits were those of households and non-financial corporations. Both sectors have been steadily building up overnight deposits since 2012; this has been observed in many euro-area countries, and especially in the four large member states. The extremely low short-term interest rates coupled with the flat yield curve are making it attractive *per se* for risk-averse investors to maintain money holdings over other forms of investment. Besides that, interest rates on other short-term deposits have moved more unfavourably than those on overnight deposits, spurring shifts within M3 into the highly liquid monetary component.

Monetary aggregates and counterparts in the euro area

Year-on-year change, 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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Loans to private non-MFIs recover further

Turning to MFI lending to non-banks in the euro area, one notable development in the quarter under review was the ongoing recovery in loans to private non-MFIs (adjusted for sales, securitisation and notional cash pooling), which saw the annual growth rate climb to 2.7% by the end of March. The gap between money and credit growth has thus narrowed considerably since mid-2015, but is still large by historical standards.

Clear growth in loans to households driven by housing loans

The largest increase was recorded in loans to households, which saw the annual growth rate rise in the reporting quarter from 2.0% at the end of December to 2.4% at the end of March. Once again, the driving force behind this was loans for house purchase, which in turn were shaped by sustained growth in the core countries, and particularly in France. However, there was also evidence of an overall upward trend in those countries where the household sector as a whole is still in the process of paring back its stock of housing loans. According to the bank managers approached for the Bank Lending Survey (BLS), the dynamic growth in household demand for housing loans also persisted in the first quarter. They stated that demand was mainly supported by the low general level of interest rates, the outlook on the housing market and the anticipated house price trend, as well as robust consumer confidence. Credit standards were loosened a little.

Marked rise in consumer credit

Consumer credit also recorded a marked increase in the first quarter, once again underpinned by the expansionary underlying trend in private consumption. The banks surveyed in the BLS reported another distinct increase in demand for consumer credit, which they attributed mainly to the strong propensity to purchase, the low general level of interest rates and stable consumer confidence. Lending standards were eased slightly, as in the preceding quarters.

Loans to non-financial corporations still on the rise as well

The other mainstay of lending to the private sector in the quarter under review was loans to non-financial corporations. Net inflows in this credit segment came to a similar volume as in the preceding quarter, with the increase in medium to long-term lending still the most significant factor (see the upper adjacent chart). Growth in loans to enterprises is currently being boosted by the very low lending rates and by the geographically broad-based economic recovery in the euro area. However, the sluggishness of investment in machinery and equipment is acting as a brake on credit growth dynamics. The growth rate of loans to non-financial corporations remained virtually unchanged on the previous quarter, at 2.3%. This is consistent with the fact that, according to the BLS results, demand for bank loans among non-financial corporations rose further in the first quarter, albeit less dynamically than in the preceding quarters. The survey respondents cited higher financing needs for inventories and working capital as well as the low general level of interest rates as major contributors to the increase. Moreover, the surveyed institutions left their lending standards for corporate customers largely unchanged.

Discernible country-specific differences in loan dynamics

As in the preceding quarters, the growth in loans to non-financial corporations in the euro area was fuelled chiefly by the contributions of banks in France and Germany. Banks in other core euro-area countries, too, appreciably expanded their lending business in this segment in the aggregate. Italy and Spain, on the other hand, again provided only very weak impetus in the first quarter. Aside from restrained investment activity, demand for loans among enterprises was dampened in specific countries, such as Germany and Spain, by the ongoing good availability of funds via internal financing. What is more, net sales of bonds issued by non-financial corporations in the euro area – particularly in France, and to a lesser extent in Germany, too – picked up in the last few quarters (see the lower adjacent chart). This development is being propelled by the favourable financing terms on the capital markets, which can be attributed in part to the Eurosystem's CSPP. This is consistent with the assessment made by the banks surveyed for the BLS that

Loans to non-financial corporations in the euro area*

€ billion, 3-month accumulated flows, end-of-quarter data, seasonally adjusted

Source: ECB. * Aggregate adjusted for loan sales and securitisation as well as for positions arising from notional cash pooling services provided by MFIs.
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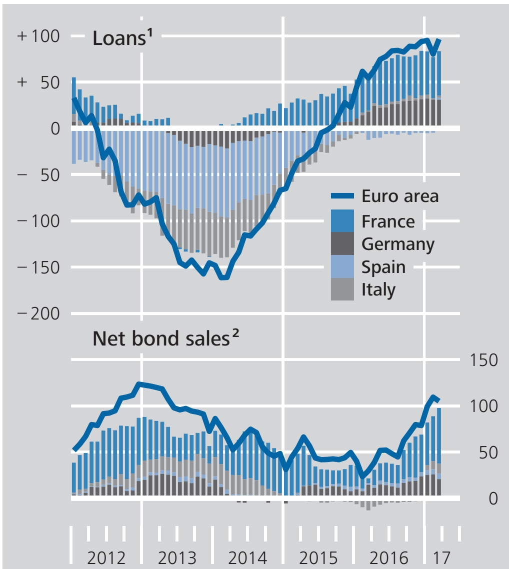
Selected components of the external financing of non-financial corporations in the euro area

€ billion, year-on-year change



Source: ECB. 1 Granted by MFIs in the countries shown. Seasonally adjusted and adjusted for loan sales and securitisation as well as (in the euro area) for positions arising from notional cash pooling services provided by MFIs. 2 By non-financial corporations in the countries shown. According to issuance statistics. Not seasonally adjusted.
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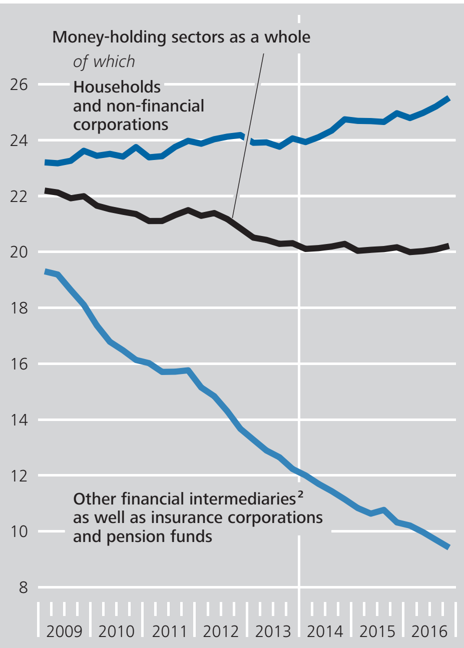
Ongoing portfolio shifts into higher-yielding assets in Germany

In an earlier work the Deutsche Bundesbank came to the conclusion that the investment behaviour of households in Germany is generally dominated to a very great extent by risk aversion and a preference for liquidity, despite the implications of the low-interest-rate environment. The Bank's economists observed that yield awareness started to pick up to a degree in 2014 but found that it was only a secondary factor overall. A stronger inclination to search for yield, relatively speaking, was identified among financial corporations, but there were no signs of any large-scale portfolio reallocations in the majority of sectors.[1]

All things considered, these developments appear to have persisted, judging by the latest data (for the year 2016) taken from the financial and monetary statistics. The money-holding sectors as a whole once again saw their bank deposits grow at a slightly quicker pace than their financial assets in 2016 (see the below chart). This development was driven by the increase in deposits of the private non-financial sector, which more than offset the drop in the deposits of financial corporations.[2] The fact that bank deposits produce lower returns on average than most other forms of investment[3] indicates that households and non-financial corporations are still less inclined overall to search for yield.

Deposits as a percentage of total sectoral financial assets in Germany

Notional stocks with base year 2000,[1] %



1 To adjust for statistical changes and revaluations. 2 Including investment funds.
Deutsche Bundesbank

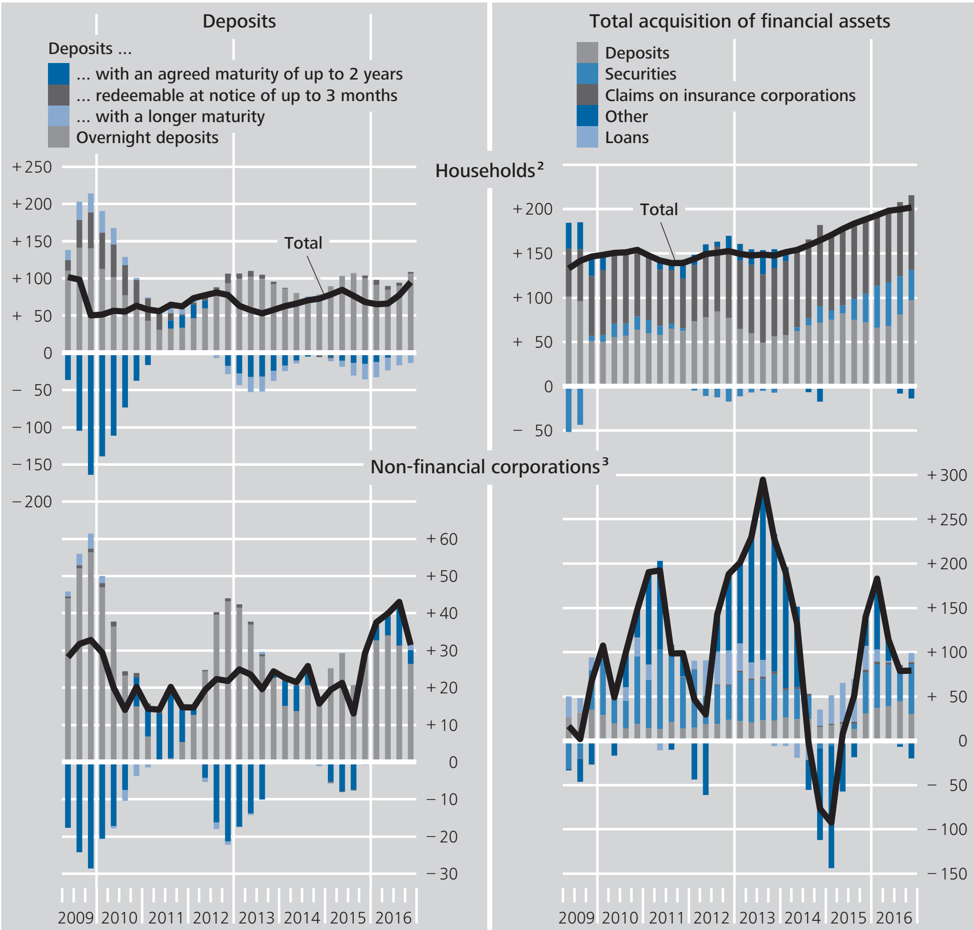
This is mainly true for the household sector, which built up deposits at an even faster pace in 2016. Households' money holdings in particular continued to be dominated by the unusually brisk build-up of overnight deposits, while the reduction of short-term time deposits as well as longer-term forms of deposit was slower than one year earlier (see the chart on page 31). Non-financial corporations likewise continued to accumulate overnight deposits in particular, even though banks lowered their interest rates on the short-term deposits of non-financial corporations even further than those of households, sometimes even moving their rates into negative territory, especially for large-scale deposits.

Turning to the other forms of investment, it was observed that households stepped up their exposures to listed shares noticeably in 2016, investing their funds in both German and foreign shares. Purchases of investment fund shares continued to play a major role as well. Hence, the importance of capital market

1 See Deutsche Bundesbank, Indications of portfolio shifts into higher-yielding assets in Germany, Monthly Report, May 2016, pp 34-37.
2 For the purposes of this box, financial corporations are defined as excluding monetary financial institutions (MFIs) as the analysis relates to the 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 See Deutsche Bundesbank, German households' saving and investment behaviour in light of the low-interest-rate environment, Monthly Report, October 2015, pp 13-31.

Build-up of deposits and total acquisition of financial assets in the private non-financial sector in Germany

€ billion, 12-month flows at quarter-end[1]



1 Adjusted for statistical changes and revaluations. Deposits figures seasonally adjusted. **2** Households including non-profit institutions serving households. **3** Including quasi-corporations.
Deutsche Bundesbank

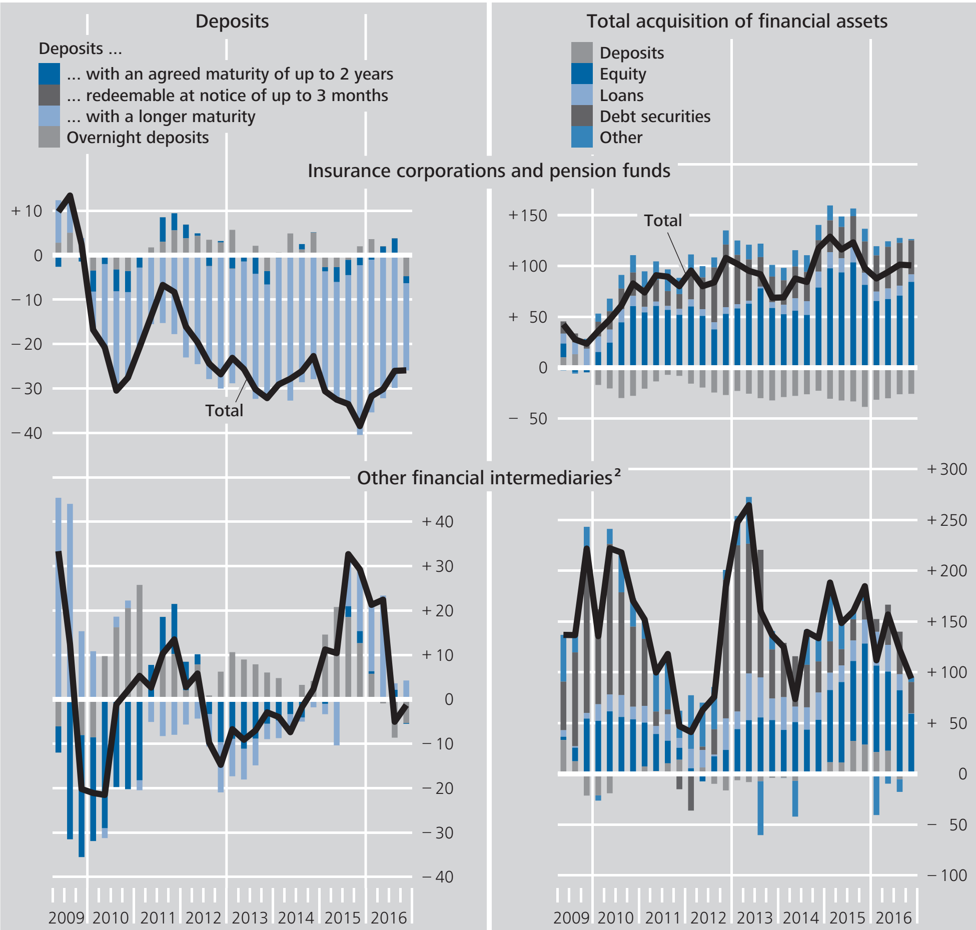
exposures has increased substantially over the past two years. While this would indicate that households, faced with historically low nominal interest rates, have certainly not turned a blind eye to yield considerations in their investment decisions, the persistently steep growth in claims on (life) insurers, along with the strong accumulation of overnight deposits, would suggest *per se* that households act primarily in a risk-averse manner.[4]

The acquisition of financial assets by non-financial corporations is another factor that is presumably still being driven less by yield considerations and more by other motives. For instance, non-financial corporations acquired far more listed shares in the context of M&A activities at the current end than one year earlier. The bulk of those shares were issued by other non-financial corporations in Germany and abroad. Intrasectoral loans granted, by contrast, were somewhat more subdued in 2016 following a rather strong showing in 2015, when loans were mainly channelled to

4 Indications that a greater number of households in Germany have adapted their saving and investment behaviour of late can also be found at the microeconomic level. For more on this topic, see P Marek, Saving patterns in the low-interest-rate setting – results of the 2016 PHF summer survey, Bundesbank Research Brief, April 2017. This survey does not indicate which forms of investment are affected by these changes, however.

Build-up of deposits and total acquisition of financial assets in the financial sector in Germany

€ billion, 12-month flows at quarter-end[1]



1 Adjusted for statistical changes and revaluations. Deposits figures seasonally adjusted. 2 Other financial intermediaries including investment funds but excluding monetary financial institutions and thus excluding money market funds.

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other non-financial corporations in the euro area.

Within the financial sector, 2016 once again saw insurance corporations and pension funds pare back their stock of deposits considerably, mainly by reducing their holdings of longer-term time deposits (see the above chart). These developments mean that investment fund shares have eclipsed deposits as this sector's most important form of investment since back in 2012; note that the stocks of debt securities now also clearly surpass those of deposits.

In 2016, insurance corporations and pension funds once again invested very heavily in investment fund shares, and their purchases of long-term debt securities (primarily foreign paper) were also up on the year. This accumulation of debt securities forms part of the portfolio shifts which can be traced back in part to regulatory requirements, ie the EU-wide introduction of Solvency II – a regime which gives insurers a stronger incentive to hedge their exposure resulting from the usually long duration of their liabilities by investing in long-term assets with the nearest-possible maturities, ie to duration-match their assets and liabilities.[5]

5 More on duration matching can be found in D Domanski, HS Shin and V Sushko (2017), The hunt for duration: not waving but drowning?, IMF Economic Review, 65 (1), pp 113-153.

The increased take-up of foreign debt securities with their frequently superior returns, meanwhile, reflects a certain search for yield. This should also be seen against the backdrop of the substantial pressure on profitability in this sector caused by the further drop in interest rates in the euro area, which is – amongst other things – a result of the expanded asset purchase programme (APP).[6]

Stocks of deposits at other financial intermediaries (OFIs)[7] barely changed over the year, and their acquisition of financial assets in 2016 was underpinned primarily by the investment activity of investment funds, which particularly acquired shares in other investment funds – a pattern which was already evident one year earlier. Similarly, direct purchases of long-term debt securities (mainly foreign paper) were a major factor in OFIs' acquisition of financial assets, bouncing back after the previous year's lull.

All in all, the changes in the acquisition of financial assets in Germany suggest that while there is an inclination to search for yield, it has not increased substantially on the year, if the aggregated data observed here are anything to go by. In particular, households' investment behaviour remains primarily risk-averse and very much geared to liquid forms of investment, though they are generally showing a greater interest in securities. Furthermore, the portfolio shifts by insurers were arguably motivated not just by purely yield-related considerations but also by an increased preference for long-dated assets on account of the low-interest-rate setting and the new supervisory regime.

6 See Deutsche Bundesbank, Risks in the life insurance sector, Financial Stability Review 2015, pp 41-55; and Deutsche Bundesbank, Funded pension providers continuing to face challenges, Financial Stability Review 2016, pp 49-66.
7 Including investment funds, but excluding monetary financial institutions and thus also money market funds.

corporate demand for loans was dampened in the reporting quarter *per se* by alternative funding sources, chiefly by internal financing and the issuance of debt securities.

Securitised lending dominated by Eurosystem bond purchases

As in the preceding quarters, monetary growth was again fuelled largely by the Eurosystem's asset purchases. This was attributable partly to the continued purchases of domestic government bonds under the PSPP, though securitised lending to the private sector also benefited, as in previous quarters, from the Eurosystem's bond purchases under the CSPP. Furthermore, amidst rising equity prices, banks also added to their equity holdings in the quarter under review.

Renewed drop in longer-term financial liabilities

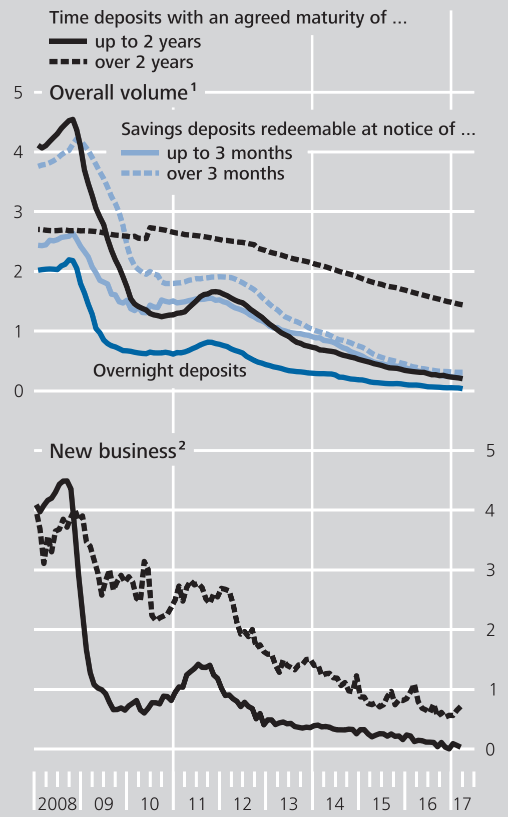
The positive impact of longer-term financial liabilities on the monetary aggregate, which has been observed since the end of 2011, continued in the reporting quarter. The money-holding sectors made further significant reductions to their stock of longer-term time deposits and savings deposits as well as longer-term bank debt securities. These developments are likely to have been boosted largely by the interest rate constellation and the Eurosystem's TLTRO II series, which represents an attractive form of funding to the banking sector.

Contribution from net external asset position still negative

On the other hand, the continued reduction in the MFI sector's net external asset position *per se* put a damper on monetary growth. Despite high current account surpluses, this counterpart has been declining since mid-2015, mainly due to the sharp upturn in net capital exports brought about by portfolio investment. The balance of payments data so far available for January and February 2017 indicate that non-resident investors again sold a large volume of euro-area government bonds in the quarter under review; therefore, the impact of the PSPP on the monetary aggregate may have been less substantial on balance than the increase in securitised lending to general government

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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might suggest.[1] Furthermore, the net external asset position was adversely affected by the fact that demand for foreign securities among domestic non-banks regained momentum in the first two months of the year.

German banks' deposit and lending business with domestic customers

Deposit growth still dominated by build-up of overnight deposits

In the first quarter of 2017, German banks' deposit business with domestic customers again saw an ongoing increase in short-term deposits and a simultaneous reduction in long-term deposits, although growth was even stronger than in the fourth quarter of 2016. Once again, inflows were most notably recorded by overnight deposits, with their growth in the January-March quarter – in contrast to the previous quarters – being supported by all money-holding sectors. The continued preference for highly liquid forms of deposit is still being driven by the historically low interest rate level and the flat yield curve (see the adjacent chart).

Growth in overnight deposits for all sectors, especially households

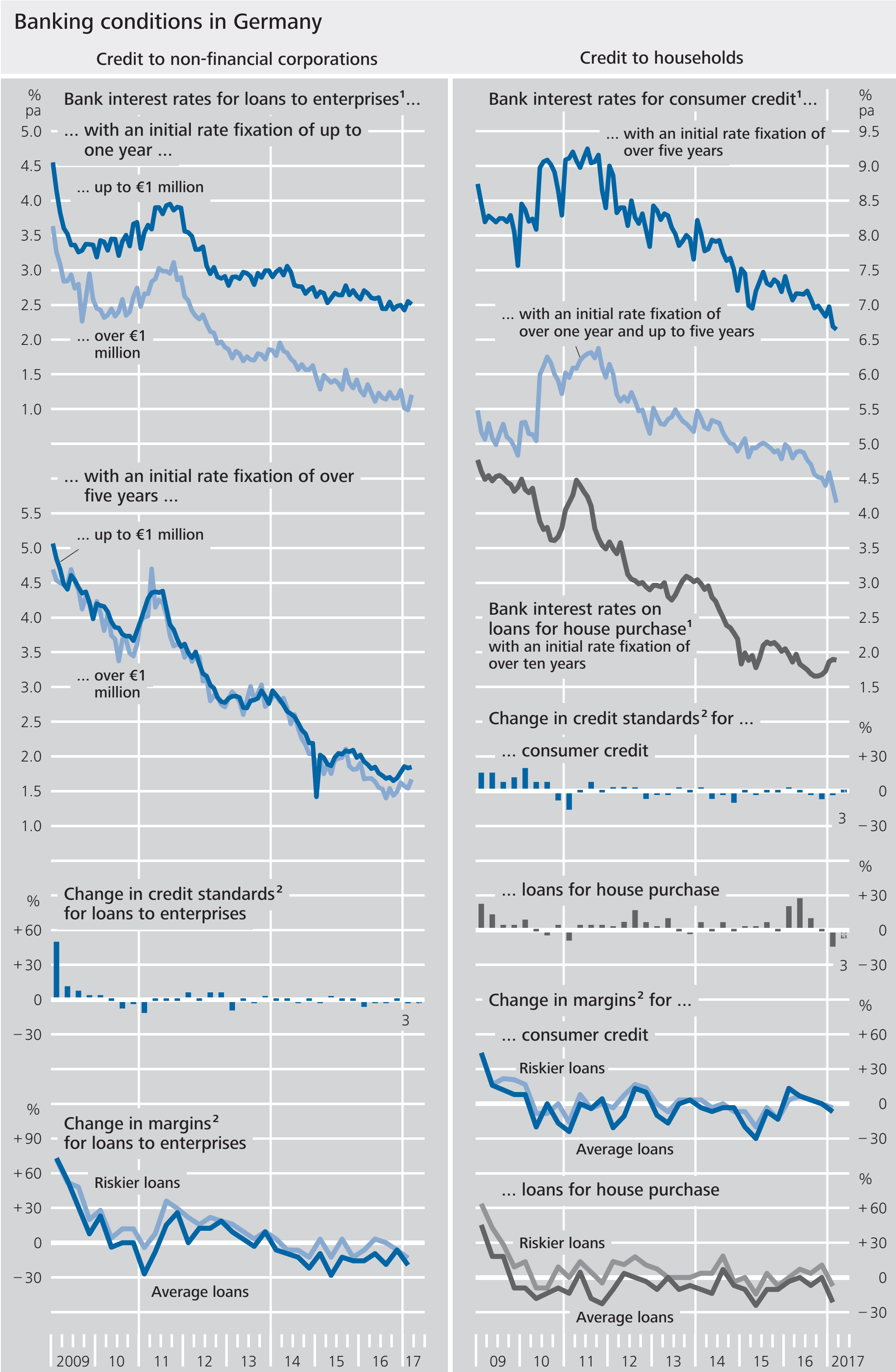
From a sectoral perspective, this development was mainly propelled by households, though their figures were slightly down on the previous quarter. As is explained in greater detail in the box on pages 30 to 33, the manner in which the other components of households' financial assets are developing suggests that the inclination to search for yield has now also become something of a factor for this sector.

The non-financial corporate sector likewise recorded high inflows for overnight deposits during the reporting quarter, even if their interest rates dwindled further and in some cases even dipped into negative territory. One reason for the marked accumulation of short-term bank deposits in this sector – besides the narrow yield premium offered by longer-term bank deposits – is likely to be non-financial corporations' high level of cash holdings at present, which is due to their strong earnings position amidst continued weak investment.

Decline in deposits in the financial sector driven by insurance corporations and pension funds

Financial corporations, whose investment behaviour is characterised more strongly by return considerations, once again had a negative impact on deposits overall. Within the financial sector, it was again insurance corporations and pension funds which reduced their long-term time deposits on a fairly large scale. This reduction is part of ongoing portfolio reallocations which – in addition to the pursuit of higher-yielding forms of investment – can also be at-

1 See Deutsche Bundesbank, How asset purchase programmes affect the consolidated balance sheet of the MFI sector, Monthly Report, November 2016, pp 28-31.



1 New business. According to the harmonised 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 2017 Q2.

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Lending and deposits of monetary financial institutions in Germany*

3-month accumulated flows in € billion, end-of-quarter data, seasonally adjusted

Item	2016 Q4	2017 Q1
Deposits of domestic non-MFIs[1]		
Overnight	31.2	43.0
With an agreed maturity of		
up to 2 years	– 5.5	5.7
over 2 years	– 3.2	– 7.0
Redeemable at notice of		
up to 3 months	– 0.6	0.0
over 3 months	– 2.2	– 1.7
Lending		
to domestic general government		
Loans	– 8.2	– 7.8
Securities	– 5.8	– 11.3
to domestic enterprises and households		
Loans[2]	16.0	19.7
of which to households[3]	9.6	12.7
to non-financial corporations[4]	4.5	5.7
Securities	5.3	– 1.4

* 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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tributed to regulatory requirements (see page 32 of the box).

Barely any increase in lending business with domestic non-banks on balance

The dynamics of German banks' lending business with the domestic non-bank sector weakened further in the first quarter of 2017. This was due to the continued decline in credit to general government, which steepened again in the quarter under review. Given the favourable fiscal situation, the further reduction in the public sector's financing needs is probably one notable factor influencing this development. However, as loans to the domestic private sector once again recorded distinct inflows at the same time, lending to the domestic non-bank sector was slightly positive overall.

Loans to the private sector driven by increased demand for loans for house purchase

Following a slight slowdown in the previous two quarters, the buoyant household demand for loans for house purchase was distinctly stronger in the reporting quarter and was again primarily responsible for the marked increase in loans to the private sector. At 3.8% at the end of March 2017, however, year-on-year growth in this credit segment was only marginally higher than at the end of the previous year.

In addition to the sound income and asset situation of households, the buoyant demand for housing loans in the quarter under review was also spurred on by the still exceptionally favourable financing conditions. Although the interest rate on long-term loans for house purchase rose according to the MFI interest rate statistics to 1.9% over the course of the first quarter, it still stood close to its all-time low since the introduction of the harmonised statistics in 2003, which it reached last September. The results of the latest BLS provide evidence of further factors influencing these developments. According to the surveyed banks, the demand for loans in this segment during the reporting quarter was not only supported by the low general level of interest rates, but also by robust consumer confidence as well as the positive outlook for the housing market and for prospective residential property price development. At the same time, the banks' lending policies helped stimulate demand for housing loans in the quarter under review, with the respondent banks having eased their credit standards for loans for house purchase markedly in net terms for the first time since 2011. In light of the buoyant demand for loans for house purchase, it remains to be seen whether this tendency will persist. For the coming quarter, the surveyed banks intend to relax their standards further on balance, albeit to a lesser extent when compared with the current level of easing.

Fresh inflows for consumer credit

Consumer credit also recorded distinct inflows in the quarter under review. This is consistent with the notable upturn in demand for consumer credit in the first quarter of 2017 revealed by the BLS data. The banks surveyed in the BLS put this increase down to consumers' stable propensity to spend, ongoing strong consumer confidence, and the low general interest rate level. The surveyed banks left their standards for consumer credit virtually unchanged.

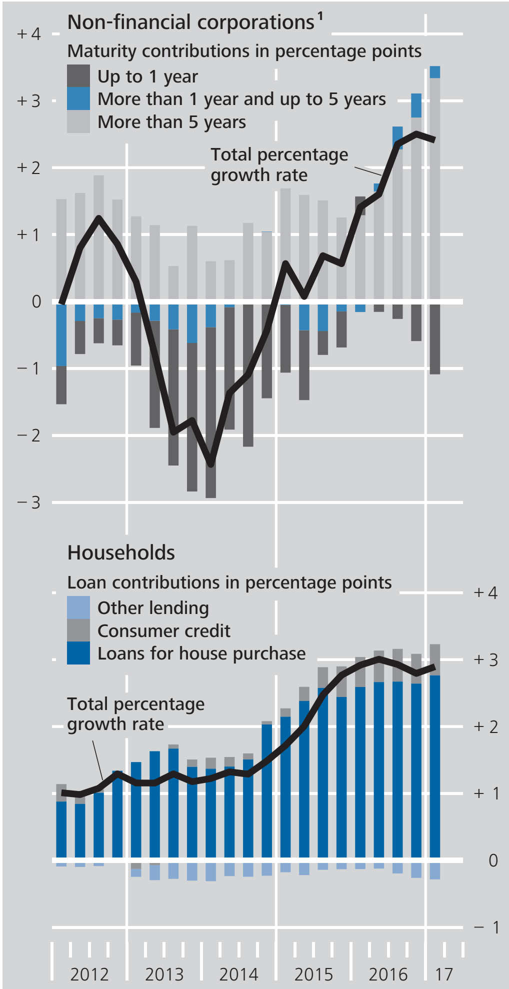
Renewed increase in lending to non-financial corporations with unchanged credit standards

Aside from loans to domestic households, banks in Germany also markedly increased their loans to non-financial corporations in the reporting quarter. At an annual rate of just under 2½% at the end of the first quarter, the pace of growth in this credit segment, however, is currently slower than that of loans to households. The upward trend exhibited by loans to enterprises is being curbed by industrial investment, which has remained subdued. Unlike in the rest of the euro area, where enterprises have a stronger inclination to take out shorter-term loans as well, German companies only stepped up their demand for long-term loans in the reporting period. Besides the exceptionally low interest rates on long-term loans, this can probably be put down mainly to the generally upbeat economic and business expectations, which strengthened enterprises' interest in long-term financing projects. The persistently weak development in short and medium-term loans should be seen against the backdrop of the abundant funds currently available to German enterprises from alternative sources of financing.

The BLS results from the first quarter of 2017 largely support these inferences. The respondent banks pointed to the financing needs for inventories and working capital as well as the low level of interest rates as the main drivers of the marked rise in demand for bank loans. By contrast, recourse to alternative sources of funding such as enterprises' use of ample internal financing means, in particular, had a dampening effect on demand. The surveyed banks reported that they had left their credit standards for lending to enterprises virtually unchanged.

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

Year-on-year changes, end-of-quarter data, seasonally adjusted



* Adjusted for loan sales and securitisation. **1** Non-financial corporations and quasi-corporations.
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Banks' profitability dented by APP and negative deposit facility rate

The BLS conducted in April contained additional questions on banks' financing conditions, the levels of credit standards, the impact of the Eurosystem's asset purchases, and the consequences for credit business of the negative interest rate on the Eurosystem's deposit facility. The German banks reported that, given the situation in the financial markets, their funding situation had shown a marked improvement compared with the preceding quarter. Relative to the midpoint of the range set by the credit standards implemented since the second quarter of 2010, credit standards for loans to enterprises and consumer credit alike are currently somewhat higher than their average level, while it turns out that the standards for loans to households for house purchase are considerably tighter than the benchmark. According to the banks, the Eurosystem's purchase programme was improving their liquidity position and funding conditions. The increase in liquidity in the past six months was chiefly the outcome of bank customers' portfolio shifts into bank deposits rather than the banks' own sales of securities. Nevertheless, the German banks taking part in the survey also reported on a broad front that the purchase programme was squeezing their net interest margins and thus denting their profitability. The negative interest rate on the deposit facility was another key factor in banks' shrinking net interest income over the past six months. Owing to the negative deposit rate, both lending rates and margins in all surveyed business lines fell, while the effects on the credit volume were limited.