

Monetary policy and banking business

Monetary policy and money market developments

ECB Governing Council again leaves policy rates unchanged

Based on its regular economic and monetary analyses, the ECB Governing Council decided to leave 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%. Purchases under the expanded asset purchase programme (APP) continue to be made at the monthly pace of €60 billion and are intended to 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.

Since the Governing Council believes that the deflation risks previously seen by a majority of its members for the euro area have disappeared, it has adjusted its expectations for the future path of key rates. It now assumes they will remain at their present levels for an extended period of time and well past the horizon of its net asset purchases, but no longer expects them to fall any further.

ECB Governing Council adjusts expectations for future interest rates

The information that has become available since April confirms the Governing Council's view that the economic dynamics in the euro area have increased and that the growth prospects have therefore improved. Ultimately, the Governing Council considers the risks to the growth outlook to be broadly balanced now. On the one hand, the positive cyclical momentum increases the chances that the economic upswing will be stronger than expected, while on the other, downside risks relating predominantly to global factors continue to exist.

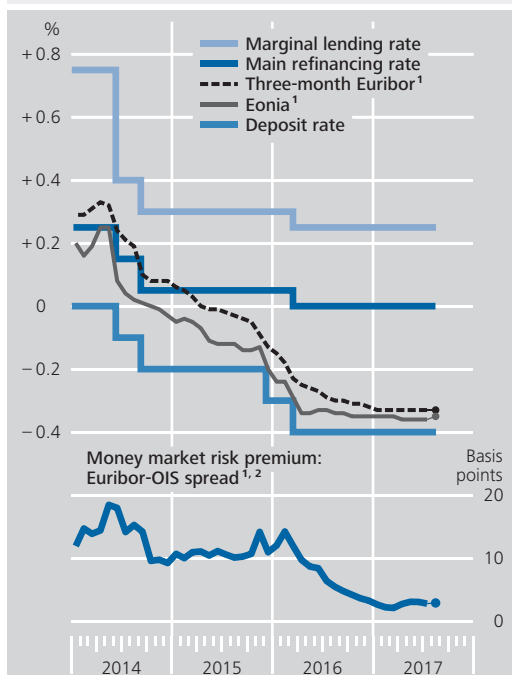
Risks to the growth outlook broadly balanced

The Governing Council, however, believes that a very substantial degree of monetary accommodation is still needed for sufficient underlying inflation pressures to build up and support headline inflation in the medium term. It is nevertheless expected that inflation will gradually increase over the medium term.

On 11 August 2017, the Eurosystem held assets in the amount of €1,680.7 billion as part of the public sector purchase programme (PSPP). The average maturity of the PSPP portfolio, which largely consists of government bonds, fell yet again slightly to 7.9 years from the previous maturity of eight years. The outstanding amounts purchased to date under the third covered bond purchase programme (CBPP3) and the asset-backed securities purchase programme (ABSPP) came to €226.1 billion and €24.8 billion, respectively. Purchases under the corporate sector purchase programme (CSPP), meanwhile, totalled €104.5 billion as at 11 August.

Purchase volumes still in line with announced target

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 17 August 2017.

Money market management and liquidity needs

The two reserve maintenance periods between 3 May 2017 and 25 July 2017 saw another significant increase in euro area liquidity needs stemming from autonomous factors (see the table below). They rose to an average of €1,088.6 billion in the June-July 2017 reserve period, which was €88.0 billion more than the average of the March-May 2017 reserve period, ie the last one prior to the period under review. The sum of the autonomous factors fluctuated considerably in the two reserve maintenance periods, moving within a corridor of €967.2 billion to €1,132.5 billion. Their increase was fuelled primarily by government deposits with the Eurosystem, which grew by €47.8 billion as against the average of the March-May 2017 reserve period, climbing to an average of €229.8 billion in the June-July 2017 reserve period. In addition, changes in the other autonomous factors also had a liquidity-absorbing effect. For instance,

comparing the averages of the same two periods, banknotes in circulation increased by €17.9 billion, and net foreign assets and other factors, which are considered together because of liquidity-neutral valuation effects, saw an aggregate decrease of €22.3 billion on balance which also removed that amount of liquidity from the banking sector. The minimum reserve requirement rose across the two reserve maintenance periods by a total of €2.0 billion to €122.6 billion in the June-July 2017 reserve period, thus additionally pushing up the calculated liquidity needs.

The total outstanding tender volume did not change substantially within the two observation periods, falling slightly by around €8 billion to just over €774 billion between the last day of the preceding period and the last day of the period under review (see the chart on page 25). The volume of longer-

Factors determining banks' liquidity*

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

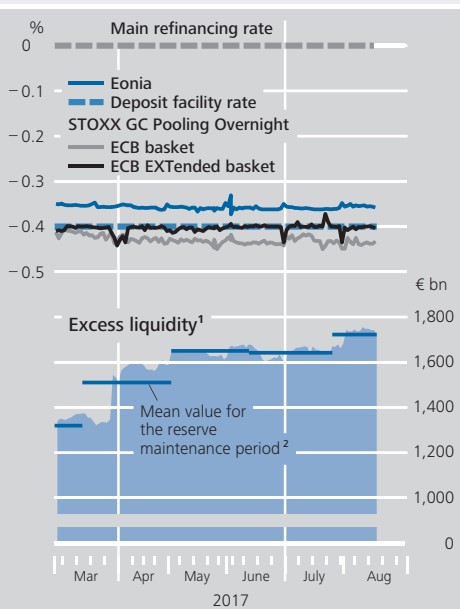
Item	2017	
	3 May to 13 June	14 June to 25 July
I Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors		
1 Banknotes in circulation (increase: –)	– 7.6	– 10.3
2 Government deposits with the Eurosystem (increase: –)	+ 18.4	– 66.2
3 Net foreign assets ¹	+ 4.5	– 26.2
4 Other factors ¹	– 18.6	+ 18.0
Total	– 3.3	– 84.7
II Monetary policy operations of the Eurosystem		
1 Open market operations		
(a) Main refinancing operations	– 4.8	– 4.3
(b) Longer-term refinancing operations	+ 60.0	+ 0.0
(c) Other operations	+ 89.7	+ 81.1
2 Standing facilities		
(a) Marginal lending facility	– 0.1	+ 0.0
(b) Deposit facility (increase: –)	– 43.7	– 1.6
Total	+ 101.1	+ 75.2
III Change in credit institutions' current accounts (I + II)	+ 97.6	– 9.5
IV Change in the minimum reserve requirement (increase: –)	– 1.7	– 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 11 August 2017
Active programmes		
PSPP	+ 136.5	1,680.7
CBPP3	+ 8.0	226.1
CSPP	+ 19.0	104.5
ABSPP	+ 0.9	24.8
Completed programmes		
SMP	- 2.2	91.2
CBPP1	- 0.9	7.5
CBPP2	- 0.9	4.9

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term refinancing operations remained almost consistent throughout the two periods, standing at €767 billion and €768 billion, respectively. Even the voluntary early repayments from the fourth TLTRO I operation, which were received on 28 June 2017, had no notable effect. They amounted to just €1.8 billion; the banks had made no use of the early repayment option, available at the same time, for the second TLTRO I operation. The total outstanding TLTRO I volume

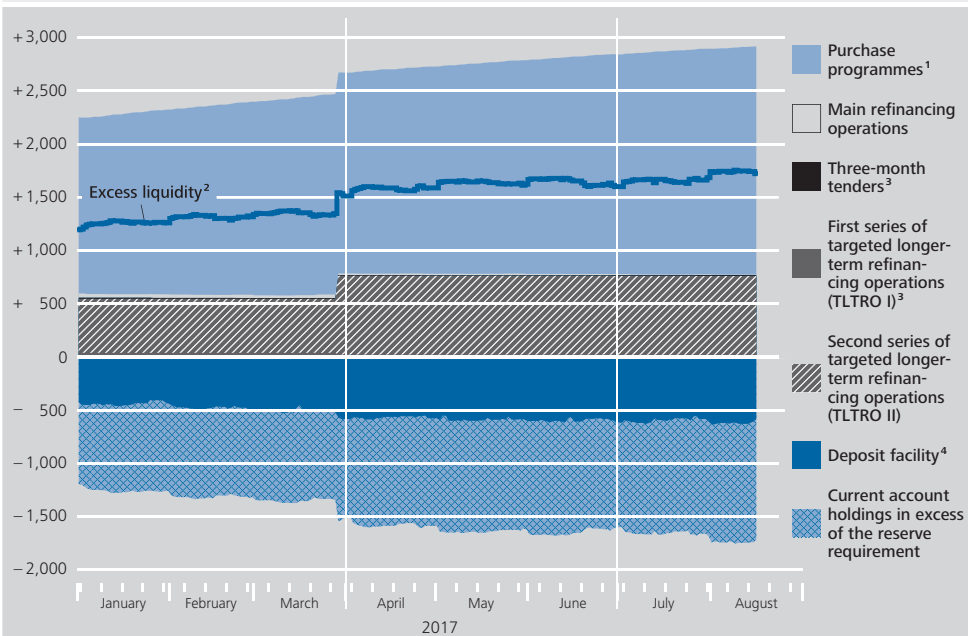
was thus reduced to €19.9 billion, while the total TLTRO II volume still remained at €740.2 billion. The slight decline in the TLTRO I volume was offset by somewhat higher demand for three-month tenders, the volume of which increased from a total of €5.4 billion at the beginning of the period under review to €7.2 billion at the end. However, the volume of main refinancing operations continued to decline, nearly halving to €9.4 billion on average in the June-July 2017 reserve period, compared with the average for the March-May 2017 reserve period (see the chart on page 26). With demand standing at €6.8 billion as at 19 July 2017, the outstanding volume of main refinancing operations hit its lowest level in the history of the Eurosystem.

The Eurosystem continued to provide the vast majority of central bank liquidity through the monetary policy asset purchase programmes (see the adjacent table). During the June-July 2017 reserve period, they represented balance sheet holdings of €2,076 billion on average, which was €171 billion higher than their average balance sheet amount in the March-May 2017 reserve period. Of all the liquidity provided through open market operations, almost three-quarters was thus accounted for by the asset purchase programmes.

Excess liquidity rose further owing to the additional liquidity provided, but the higher calculated liquidity needs stemming from autonomous factors and the minimum reserve requirement moderated the increase. These countervailing effects arising from additional liquidity provision and higher liquidity needs were particularly evident in the June-July 2017 reserve period, in which average excess liquidity for the period fell relative to the previous period for the first time since early 2015, albeit only slightly, by €8 billion. However, owing to the May-June 2017 reserve period's high increase of €140 billion on average compared with the previous period, excess liquidity rose overall in

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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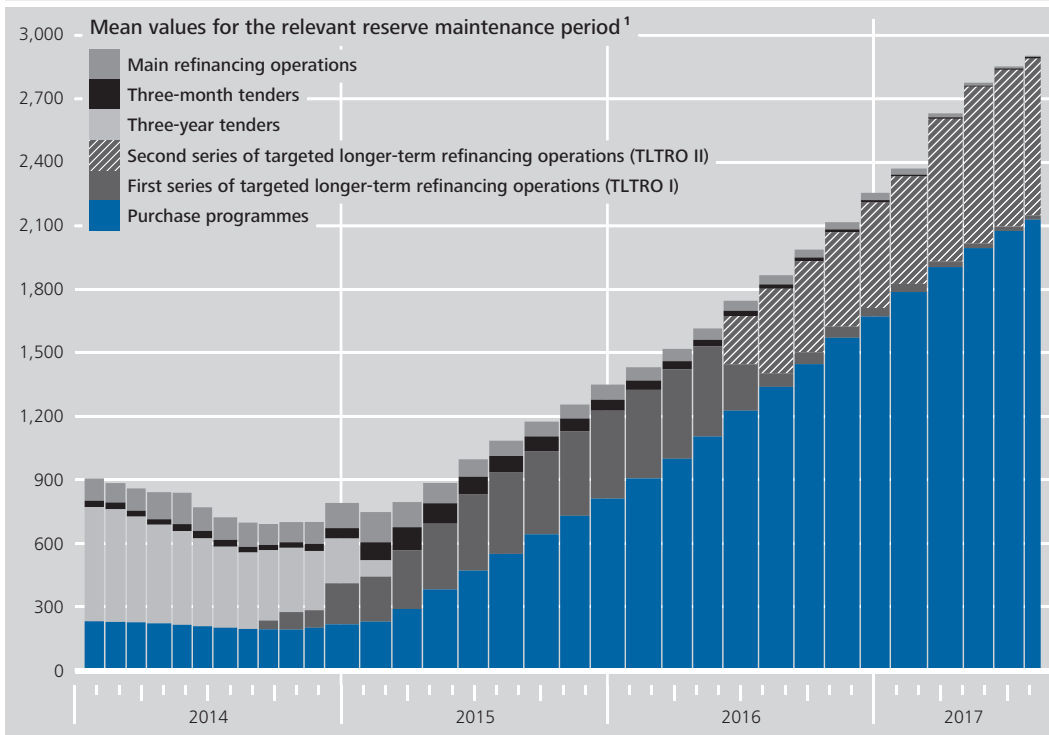
the period under review, climbing to an average of €1,642 billion in the June-July 2017 reserve period. As in the previous period, in each of the two observation periods 36% of excess liquidity was attributable to use of the deposit facility and 64% to excess reserves in the form of current account holdings; in other words, even though the level of excess liquidity changed, its distribution across these two components remained constant.

The abundant supply of liquidity meant that overnight rates remained geared to the rate on the deposit facility during the period under review (see the chart on page 24). Eonia almost consistently stood at -0.36%, which was 4 basis points higher than the deposit facility rate. At the same time, the underlying turnover decreased markedly to an average of €6.3 billion, following on from €9.2 billion in the two preceding periods. By contrast, secured overnight money in GC Pooling (ECB basket) still

traded below the deposit facility rate in both of the observation periods, at an average of -0.43%, which was thus again 1 basis point lower than the average of the two previous periods. The rate for secured overnight money in the ECBEXTended basket, which contains a larger set of eligible securities, continued to move within a very narrow range around the deposit facility rate, again trading at an average of -0.40%. The associated overnight turnovers in the ECB and ECBEXTended baskets rose slightly in total to an average of €6.1 billion, compared with €5.6 billion in the two preceding periods. The end of the half-year at the close of June resulted in the rate for secured overnight money in the ECBEXTended basket temporarily dropping by just over 3 basis points to -0.435% on that day, while Eonia rose simultaneously by 1 basis point to -0.35%.

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 maintenance period. The last period displayed is still ongoing.
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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 €88 billion to €1,742 billion. This increase was mainly propelled as before by the continued asset purchases, while volumes in the standard tender operations eased again slightly. The purchases planned during the further course of the year under the APP are expected to increase excess liquidity further.

Market participants expect first policy rate increases at the beginning of 2019

The unsecured overnight money market rate (Eonia) hovered in a narrow range of between -0.35% and -0.36% during the period under review, just above the deposit facility rate of -0.40%, while the secured overnight rate (STOXXGC Pooling) was slightly below that level. The three-month Euribor was largely unchanged in the reporting period, standing at -0.33% at last report. On the whole, money market rates have thus remained largely static for several months now. Forward rates again fluctuated sharply during the period under

review, reflecting ongoing market uncertainty over the future path of monetary policy rates (more on market movements towards the end of the second quarter can be found in the article on pages 38 to 49). Money market forward rates currently suggest that market participants are pricing in a first hike of 10 basis points in the deposit facility rate for the beginning of 2019.

Monetary developments in the euro area

The broad monetary aggregate M3 again expanded considerably in the second quarter of 2017, registering an annual growth rate at the end of June of 5.0%, the level seen since April 2015. The continued expansion of the money stock can be explained by the money-holding sector's ongoing strong preference for overnight deposits given the low opportunity costs. A glance at the counterparts reveals that MFI

Monetary dynamics still influenced by expansionary monetary policy

Consolidated balance sheet of the MFI sector in the euro area*					
Quarter-on-quarter change in € billion, seasonally adjusted					
Assets	2017 Q2	2017 Q1	Liabilities	2017 Q2	2017 Q1
Credit to private non-MFIs in the euro area	54.6	148.5	Central government deposits	- 7.6	- 16.1
Loans	17.9	98.8	Monetary aggregate M3	90.4	215.4
Loans, adjusted ¹	43.4	87.1	of which Components		
Securities	36.7	49.6	Currency in circulation and overnight deposits (M1)	159.2	204.3
Credit to general government in the euro area	21.2	78.3	Other shorter-term bank deposits (M2-M1)	- 23.9	- 7.5
Loans	- 3.2	- 11.0	Marketable instruments (M3-M2)	- 44.9	18.6
Securities	24.0	88.7	MFI longer-term financial liabilities	- 25.2	- 5.0
Net external assets	- 17.9	- 33.6	of which		
Other counterparts of M3	0.1	1.6	Capital and reserves	- 3.1	42.6
			Other longer-term financial liabilities	- 22.1	- 47.7

* 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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lending to non-banks in the euro area – including by the Eurosystem – was once again the most significant driver of monetary growth. Bank loans to households, in particular, continued to increase in the quarter under review. All in all, loan growth was boosted by robust and broad-based economic growth and by the very low interest rate level. At the same time, securitised lending to general government and private non-banks also rose, albeit at a slightly more moderate pace on account of the reduced volume of asset purchases by the Eurosystem since April 2017.

MFI lending to non-banks in the euro area was again the counterpart that did the most to propel monetary growth during the quarter under review. The pace of growth did, however, recede significantly compared with the preceding quarters, owing to securitised lending to general government on the one hand and to loans to enterprises on the other. Volatile loans to financial corporations saw appreciable net outflows, while loans to non-financial corporations, which have likewise fluctuated noticeably in recent quarters, recorded lower net inflows. The annual growth rate of loans to private non-banks adjusted for securitisation and other one-off effects was consequently slightly down on the quarter at 2.5% in the quarter under review. The gap between monetary aggregate and loan growth is therefore significantly narrower than in mid-2015; it did not narrow any further in the second quarter, however.

Lending to domestic non-banks the largest counterpart once again

Overnight deposits still main driver of M3 growth

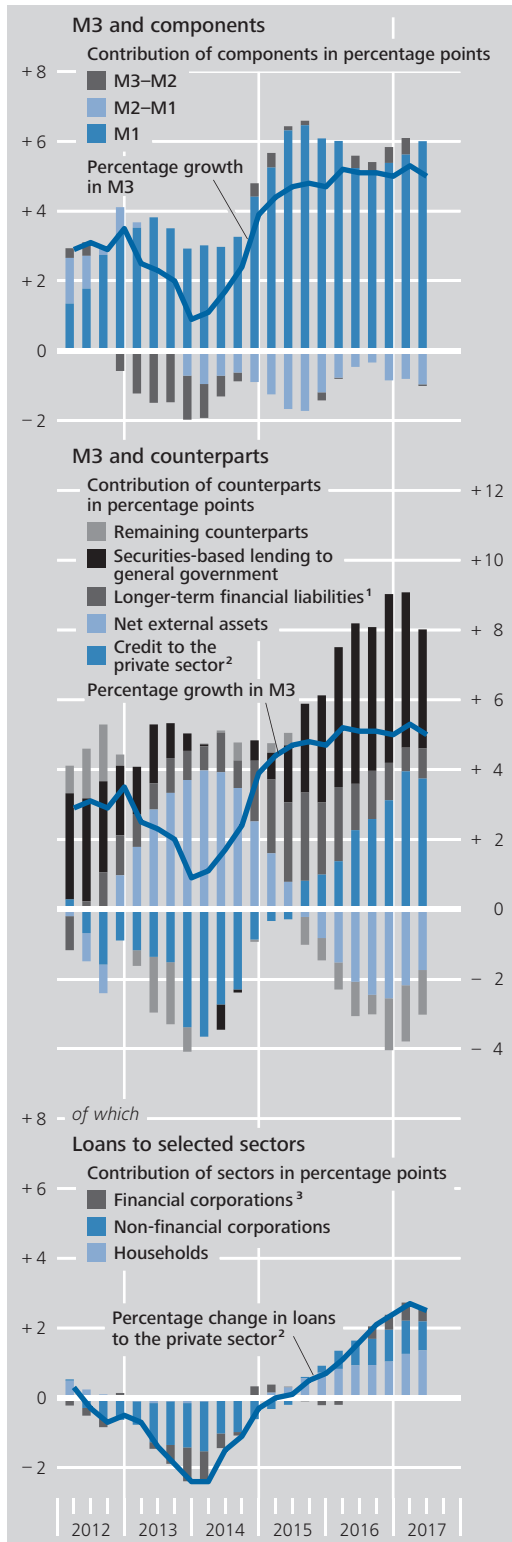
Money growth was again dominated by strong inflows into overnight deposits in the second quarter of 2017. These mostly originated from households and non-financial corporations, which have been building up increasing volumes of overnight deposits since back in 2012. Money holdings also remained attractive to these risk-averse sectors during the period under review due to the narrow yield spread between long-term government bonds and monetary components. Within M3, shifts from short-term time deposits to short-term savings deposits and especially to overnight deposits continued as the minimal interest rate spreads between these types of deposit still favoured highly liquid components.

As in the preceding quarter, loans to households contributed the most to loan growth. Once again, the driving force behind this was loans for house purchase, the annual growth rate of which rose from 3.0% at the end of March to 3.3% by the end of June. The largest contributions in terms of volume came from Germany and France; that said, increasing – that is to say: less negative – growth rates

Clear growth in loans to households driven by housing loans, ...

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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were also observable particularly in euro area countries in which the household sector as a whole is still in the process of scaling back its stock of housing loans. The Bank Lending Survey (BLS) for the second quarter found that household demand for loans for house purchase also picked up in the second quarter, though the pace of growth fell slightly short of the rate observed in the previous two quarters. Euro area banks cited the low general interest rate level, stable consumer confidence and a still-upbeat household assessment of the outlook for the residential real estate market as explanatory factors for the rise in the need for funds. Credit standards remained essentially unchanged on balance.

Consumer credit, too, continued to expand strongly during the period under review, its annual growth rate climbing to 5.8% by the end of June. Upward momentum was evident in all four of the largest countries in the euro area, which probably ties in closely with the persistently expansionary underlying path of private consumption. This is consistent with the view expressed by the banks surveyed in the BLS that demand for consumer credit had increased yet again. Respondents mainly put this down to the low general level of interest rates and the high propensity to purchase. On balance, credit standards remained virtually unchanged.

... but also continued substantial growth in consumer credit

Net growth in loans to non-financial corporations in the euro area slowed down significantly on the two preceding quarters, reducing the annual growth rate from 2.4% at the end of March to 2.1% at the end of June. This decrease was to a significant extent due to a one-off special effect, which is unlikely to have a lasting impact on the recovery in loan growth that has been observed for quite some time now.¹ For one thing, there was a favourable setting for a continued recovery in loans to enterprises, with economic growth becoming entrenched and evident across wide parts of

Growth in loans to non-financial corporations down on previous quarters

¹ See also Monetary developments in the euro area: June 2017, ECB press release dated 27 July 2017.

the euro area. For another, lending rates throughout the currency area are still close to historical lows. This upbeat overall setting is consistent with reports by the banks which participated in the BLS that euro area demand among non-financial corporations for bank loans picked up perceptibly in the second quarter. Besides pointing to the financing requirements for mergers, acquisitions and restructuring measures, the low general interest rate level and the need for funds arising from debt restructuring, refinancing and renegotiations, BLS respondents also put this stronger demand down to a rise in the funds needed for fixed investment, which has not increased this sharply since the final quarter of 2015. At the same time, survey respondents said that, on balance, they had largely left their standards for loans to enterprises unchanged at the previous quarter's level.

Discernible country-specific differences in loan dynamics

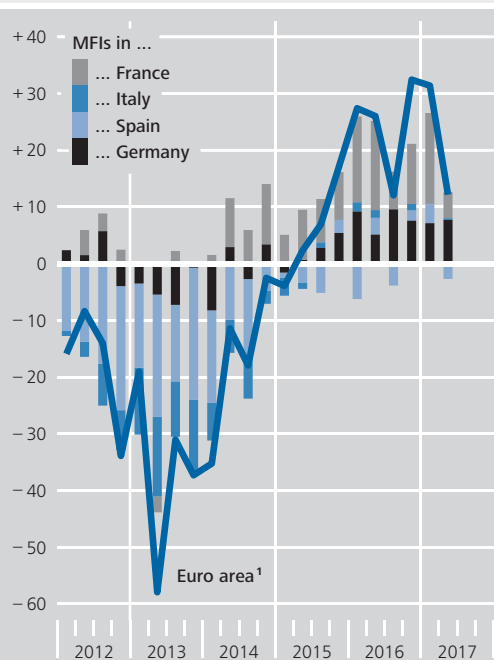
As in the preceding quarters, growth in loans to non-financial corporations in the euro area was fuelled chiefly by the contributions of banks in Germany and, to a lesser extent, France (see the upper adjacent chart). In some countries, such as in Germany and Spain, the ongoing high availability of funds via internal financing was one major factor dampening enterprises' demand for loans. On aggregate, they were thus able to finance their resurgent investment without having to borrow funds. Furthermore, a glance at data for the euro area as a whole reveals that debt securities issuance is another external source of financing, alongside loans, which has been gaining significance in annualised terms since 2016 for the non-financial corporate sector. One important factor here is the favourable financing terms in the capital markets, which can be attributed in part to the Eurosystem's asset purchase programmes.

Securities-based lending bolstered by Eurosystem's asset purchases

The Eurosystem's asset purchases remained a key driver of monetary growth in the second quarter of 2017. However, the pace of growth was braked somewhat *per se* by the reduction in the monthly volume of purchases made by

Loans to non-financial corporations in the euro area*

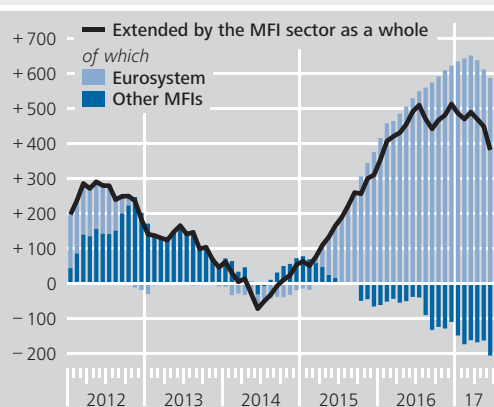
€ billion, 3-month accumulated flows, end-of-quarter data, seasonally adjusted



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

Securities-based lending to general government in the euro area

€ billion, 12-month accumulated flows

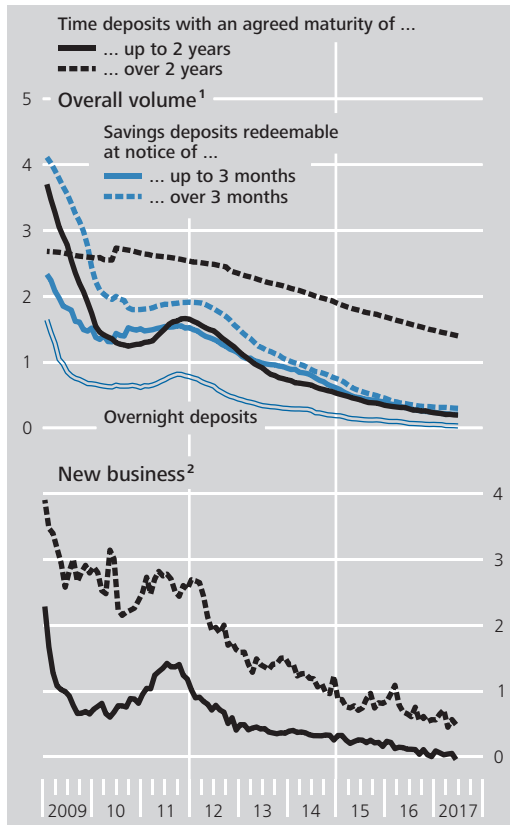


Sources: ECB and Bundesbank calculations. Deutsche Bundesbank

the Eurosystem since April 2017. Furthermore, the PSPP made less of a contribution to this monetary aggregate counterpart than in the preceding quarters as the Eurosystem's net purchases of domestic government bonds were partly offset in the reporting quarter by increased net sales by other MFIs (see the lower

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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chart on page 29). In securities-based lending to the private sector, debt securities benefited from the CSPP, as in previous quarters; in an environment of rising equity prices, MFIs also held more shares and investment fund shares in the quarter under review.

The supportive effect of longer-term financial liabilities on the monetary aggregate, which has been observable since the end of 2011, lasted into the reporting quarter. Given the current interest rate levels, longer-term time deposits, in particular, continued to be pared back significantly. By contrast, the previous quarters' rather sharp reduction in longer-term bank

Continued reduction in longer-term financial liabilities

bonds held by the money-holding sector came to a halt during the second quarter of 2017. One likely reason for this is the expiry in March this year of the Eurosystem's (extremely favourable) targeted longer-term refinancing operations (TLTROs), which took away a major source of alternative funding for the banking sector.

Viewed in isolation, the ongoing reduction in the MFI sector's net external asset position continued to put a damper on monetary growth. Although this impact weakened slightly in the reporting quarter in view of persistently high current account surpluses and the economic upturn in the euro area, the balance of payments data so far available for April and May 2017 indicate that non-resident investors again sold a discernible volume of longer-term bonds in particular, both from the private sector and the general government sector in the euro area. At the same time, domestic non-banks' demand for foreign securities in these two months remained high, meaning that, on the whole, persistently high net capital exports were recorded in portfolio investment.

Contribution from net external assets still negative but more moderate than in previous quarter, despite persistently high net capital exports

German banks' deposit and lending business with domestic customers

Once again, German banks' deposit business with domestic customers grew significantly in the second quarter of 2017. As in the previous quarters, though, this was attributable solely to growth in short-term bank deposits (more specifically: overnight deposits), while long-term deposits declined further on balance. This build-up of highly liquid transferable deposits in the quarter under review was aided by the historically low interest rate level and the flat yield curve, and was supported by nearly all the money-holding sectors (see the adjacent chart).

Deposit growth still dominated by build-up of overnight deposits

Households continued to make the largest contribution to this growth in short-term deposits. The ongoing preference among households for

Real portfolio returns of households in Germany

Time and again, the prevailing low-interest-rate environment has ignited public debate over the low deposit rates earned by German savers. However, and as the Bundesbank has demonstrated in earlier analyses, savers' financial portfolios also contain, besides bank deposits, other forms of investment which have a role to play – one which, at times, is even as important as that of bank deposits. Hence, a comprehensive picture of households' portfolio returns needs to incorporate the returns generated by these other types of financial asset – that is, the yields generated by claims on insurance corporations, say, or valuation gains and losses and dividend payouts on securities.¹ Since the purchasing power of nominal returns varies with the inflation rate, our analysis observes the various rates of return in real terms.²

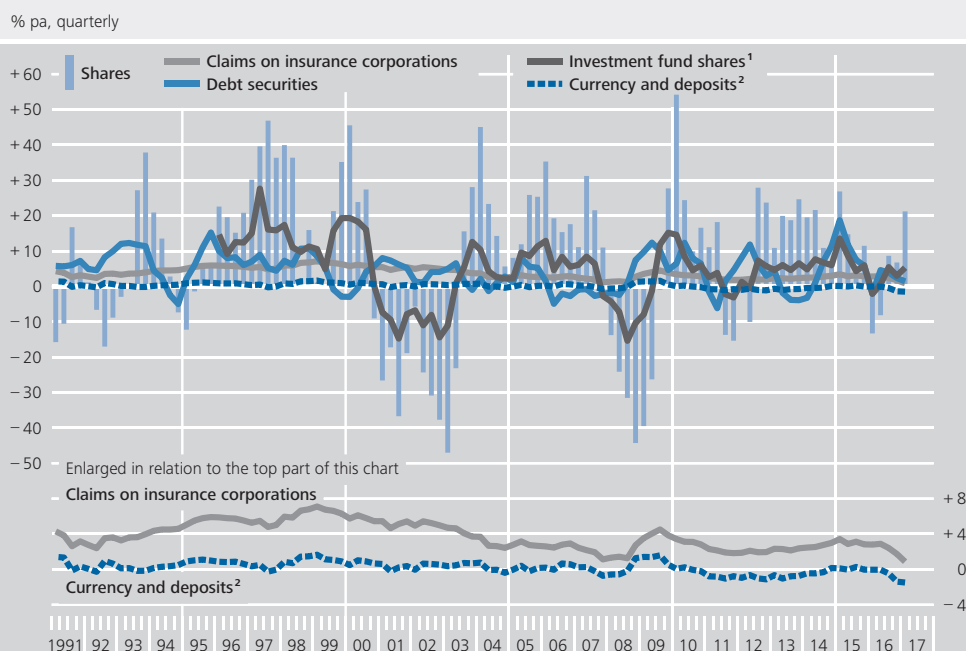
Below is an updated version of the chart published in the Deutsche Bundesbank's October 2015 *Monthly Report* showing how real returns on the main types of financial asset that feature in German households' portfolios evolved between 1991 and the first quarter of 2017.

Securities returns in particular remained relatively high into 2015 before dwindling

¹ Details on the path of returns and the impact on household behaviour can be found in Deutsche Bundesbank, German households' saving and investment behaviour in light of the low-interest-rate environment, *Monthly Report*, October 2015, pp 25ff.

² More on this topic can also be found in Deutsche Bundesbank, Developments in real interest rates on deposits in Germany, *Monthly Report*, July 2017, pp 101-103; and Deutsche Bundesbank (2017), Return on private financial assets taking into account inflation and taxes, *op cit*, pp 69-75. Our analysis does not adjust returns for taxes, though the overall qualitative outcome would be similar if we did.

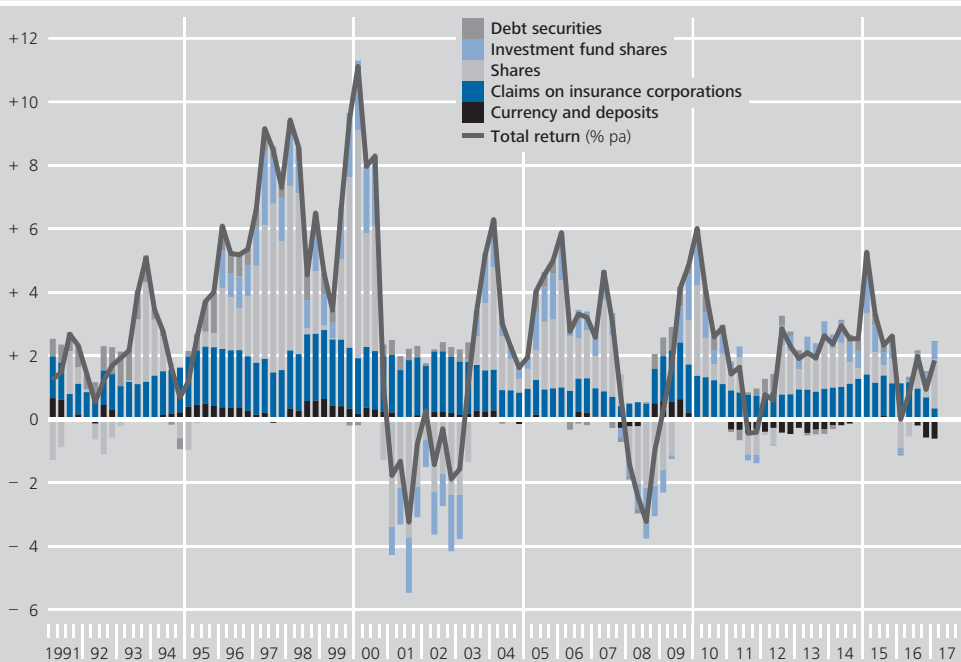
Real returns on various types of financial asset held by households in Germany



Sources: Thomson Reuters Datastream, Assekurata, German Insurance Association (Gesamtverband der Deutschen Versicherungswirtschaft) and Bundesbank calculations. ¹ Data on the annual return on investment fund shares are only available as from 1995 Q4. ² Nominal deposit interest rates are based on the Bundesbank's interest rate statistics until 2002 and on the harmonised MFI interest rate statistics as from 2003. The period prior to 2003 and the years from 2003 onwards can therefore only be compared to a limited degree.

Contribution of individual types of financial asset* to the real total return of households in Germany

Percentage points



* Weighted according to share of total financial assets.
 Deutsche Bundesbank

as that year progressed. Those returns may have slightly underperformed 2015 levels on the whole since then, but the return on shares, especially, has climbed noticeably to date, largely on the back of valuation gains in the capital market. At the same time, the returns on bank deposits (including currency) and on claims on insurance corporations fell appreciably, the former dropping to well below zero at last count. This was due chiefly to the prevailing rise in the rate of inflation since mid-2016.

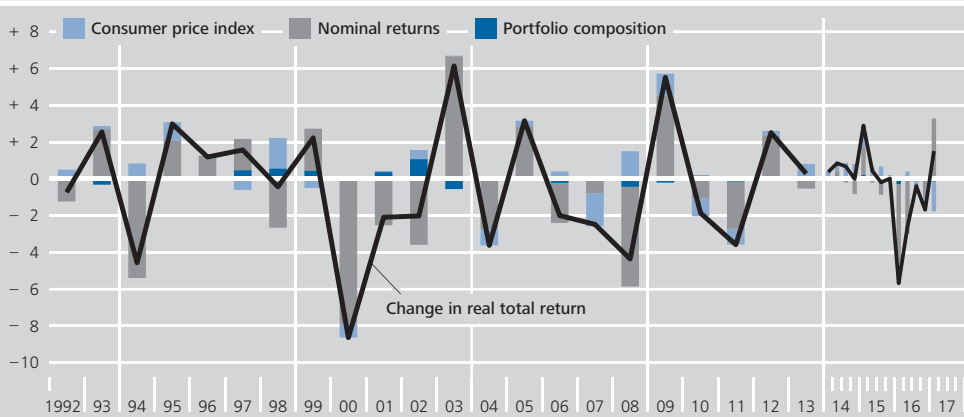
We measure the real total return on the financial portfolios of German households in the period under review by weighting the individual returns with the time-varying portfolio share of each type of financial asset. As the above chart shows, this total return, though low at the current end, is nonetheless still in positive territory, coming in at just shy of 1.9% in the first quarter of 2017. While this is down on the long-term

average of 2.8% observed since 1991, it is a little higher than the mean value of 1.7% recorded since 2008.

One contribution to the total return that has been positive and noteworthy throughout came from claims on insurance corporations, though their return, too, has shrunk significantly since 2016. The contribution from securities has likewise been positive for the most part, but their relatively small portfolio share – especially since 2009, at less than one-quarter – means that their sometimes very high returns in recent years have had no more than a limited effect on the total return of German households. Bank deposits (including currency), which currently represent a very substantial portfolio share of just under 40%, on the other hand, contributed far less still to the total return throughout the observation period, or even eroded it at times.

Contributions to the change in the real total return

Year-on-year change in percentage points



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The chart above illustrates year-on-year changes in the total return and a break-down into its contributory factors, including changes in the nominal total return and inflation (measured with the aid of the consumer price index (CPI)) as well as shifts in relative portfolio composition. Essentially, these shifts can be triggered either by transaction-driven inflows into individual types of financial asset, ie active portfolio reallocations, or by valuation effects, which largely affect the stocks of securities held in the portfolio.

Developments in nominal returns were, in nearly all cases, the key factor for the real return on the portfolio. Particularly in periods of crisis, such as between 2000 and 2002 (the end of the New Economy boom) or in 2007-08, there were negative contributions from nominal returns, largely as a result of price losses. A similar pattern can be identified for the year 2016. Moreover, it is always found that movements in the CPI make a smaller, albeit significant contribution, where, in the above chart, a year-on-year increase produces a negative contribution, given that it depresses the real total return when viewed in isolation. Shrinking but still-positive rates of inflation meant that the CPI continued to make a positive

contribution to the path of the real return in 2014 and 2015. However, inflation rates have been picking up again since mid-2016, meaning that contribution has been negative.

Changes in portfolio composition usually only have a minor impact on the portfolio return, though the year 2002, when the New Economy boom came to an end, stands out as a notable exception. That was a period in which investors offloaded appreciable stocks of loss-ridden shares and switched to bank deposits, which were yielding positive real returns back then. The otherwise negligible role played by changes in portfolio composition is consistent with the observation that German households' portfolio structure tends to be less sensitive to returns and is instead driven chiefly by personal preferences as well as by slow-moving demographic and institutional factors.³

³ See Deutsche Bundesbank (2015), op cit, pp 25ff.

Lending and deposits of monetary financial institutions in Germany*

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

Item	2017	
	Q1	Q2
Deposits of domestic non-MFIs ¹		
Overnight	43.0	47.4
With an agreed maturity of		
up to 2 years	5.8	-6.2
over 2 years	-7.0	-7.0
Redeemable at notice of		
up to 3 months	0.0	1.7
over 3 months	-1.7	-0.7
Lending		
to domestic general government		
Loans	-7.8	-6.9
Securities	-11.3	-5.9
to domestic enterprises and households		
Loans ²	19.7	22.7
of which to households ³	12.7	13.6
to non-financial corporations ⁴	5.7	7.4
Securities	-2.0	8.2

* 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.
 Deutsche Bundesbank

Private non-financial sector contributes most to growth in overnight deposits

highly liquid bank deposits that can be observed here suggests that the portfolio structure of households in Germany tends to be less sensitive to returns (see the box on pages 31 to 33). This is also consistent with the observation that portfolio shifts into higher-yielding types of financial asset are still of relatively little importance for this sector.

Non-financial corporations, too, stepped up their overnight bank deposits to a considerably greater extent than in the previous quarter, in spite of the low and, in some cases, even negative interest rates on offer. Besides the still very marginal yield disadvantage relative to other

deposit types, this sector's strong inflows into transferable deposits are also likely to be aided by German non-financial corporations' high level of cash holdings at present, which is due to their strong earnings position.

Financial corporations likewise continued to build up their overnight bank deposits during the reporting period. On balance, however, they decreased their deposits held with domestic banks because all other bank deposits, and in particular the long-term time deposits of insurers and pension funds, saw significantly sharper declines. On the whole, then, the investment decisions of this sector are likely to have again been driven by a search for higher-yielding types of financial asset and by regulatory requirements during the reporting quarter.²

Decline in deposits in the financial sector driven by insurers and pension funds

Banks' lending business with the domestic non-bank sector gained distinct traction in the reporting quarter. As in the previous quarters, however, this upswing was due solely to the stronger flow of credit to private non-banks. In addition to loans to the private sector, banks also added to their stocks of privately issued securities, which they had reduced discernibly in the preceding quarter. At the same time, domestic banks reported yet another decline in lending business with the domestic public sector, affecting both securitised lending as well as loans, and reflecting a further reduction in financing needs as a result of the favourable state of public finances.

Stronger growth for lending to domestic non-banks

As in the previous quarters, a large proportion of the loans to the private sector were granted to households, in particular in the form of loans for house purchase, for which demand was roughly as buoyant as during the preceding quarter. At 3.9% at the end of June, however, year-on-year growth in this credit segment – which was supported by exceptionally fa-

Loans to households still dominated by loans for house purchase

² See Deutsche Bundesbank, Ongoing portfolio shifts into higher-yielding assets in Germany, Monthly Report, May 2017, pp 30-33.

avourable interest rates – was only marginally higher than at the end of the previous quarter. Thus, the interest rate on long-term loans for house purchase barely changed over the course of the second quarter, ending the quarter at 1.9%, which is just above its all-time low since harmonised MFI interest rate statistics were introduced in 2003, which it reached last September.

The BLS data likewise show that, all other things being equal, the low general level of interest rates once again boosted demand. By contrast, the positive outlook for the housing market (including for anticipated residential property prices going forward), which respondents had cited in the previous quarters as a key factor driving demand, played only a secondary role for the first time in around seven years. The BLS also revealed that unlike in the previous quarters, consumer confidence was no longer a notable source of demand-side stimulus. However, the view expressed on the whole by the bank managers surveyed in the BLS – that demand for loans for house purchase had eased somewhat overall in the second quarter of 2017 – can mainly be put down to a number of respondents having lost market share to competitors within and outside the sample. On balance, the banks participating in the BLS left their credit standards for loans for house purchase unchanged.

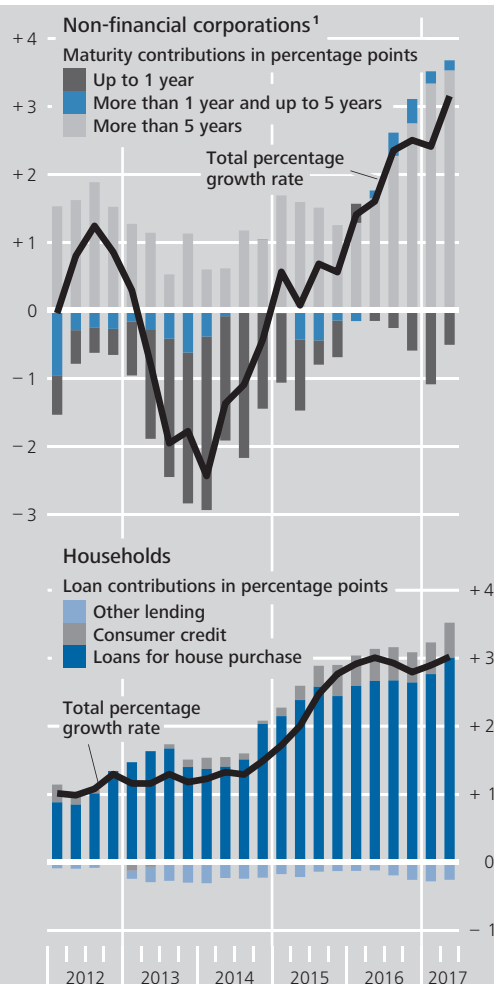
Fresh inflows for consumer credit

Consumer credit also increased markedly in the reporting quarter. This is consistent with the BLS data showing at least a slight rise in demand for this type of lending in the second quarter of 2017, which the bank managers responding to the survey attributed to consumers' increased propensity to purchase, strong consumer confidence and the low general interest rate level. The respondent banks did not change their credit standards in this segment.

In addition to loans to households, lending to non-financial corporations also recorded marked inflows. With an annual growth rate of

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

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



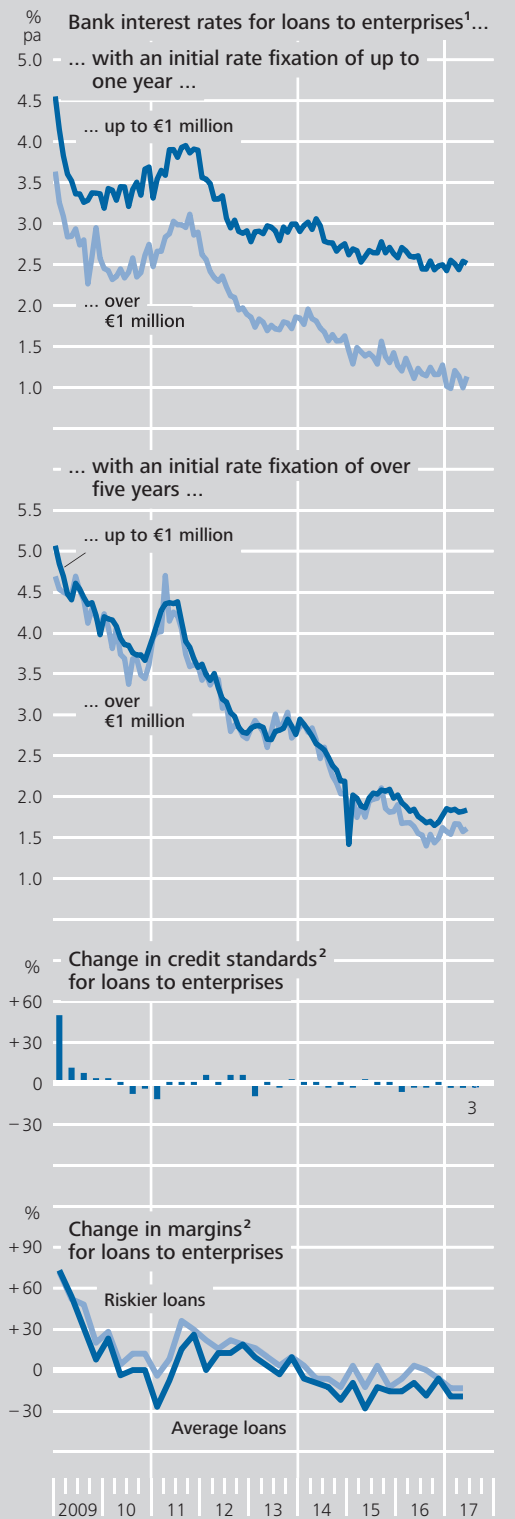
* Adjusted for loan sales and securitisation. ¹ Non-financial corporations and quasi-corporations.
 Deutsche Bundesbank

3.2% at the end of June, this credit segment is now even slightly outpacing loans to households, which expanded at a rate of 3.0%. In terms of maturities, non-financial corporations in Germany continued to show a stronger preference for long-term loans. Unlike in the previous quarters, there was also demand from non-financial corporations for shorter-dated loans on balance, albeit on a much smaller scale. Besides the exceptionally low interest rates, German enterprises' greater interest in long-term loan contracts on the whole can probably be explained by the generally upbeat underlying economic and business expectations. For their short and medium-term ex-

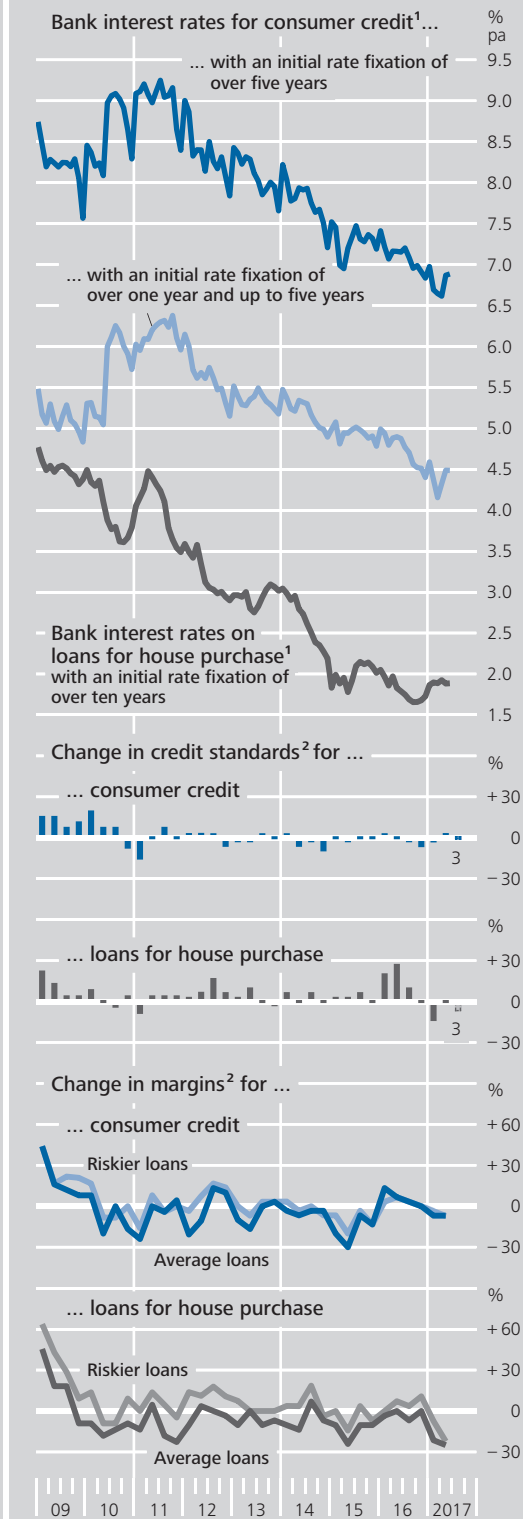
Renewed increase in lending to non-financial corporations

Banking conditions in Germany

Credit to non-financial corporations



Credit to households



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 Q3.

penditure, German enterprises are likely to have access to ample internal resources and/or alternative sources of funding, such as intra-group loans, trade credits and loans from shadow banks.

The latest BLS results generally underpin this assessment, with the respondent banks reporting only a moderate rise in demand in this credit segment during the second quarter of 2017. At the same time, they identified the vast scope for internal financing available to enterprises as a major factor dragging on demand. By contrast, according to BLS data, demand for loans was especially supported by funding needs for refinancing, restructuring and renegotiation purposes, as well as by the low general level of interest rates. For example, at the end of June, domestic enterprises paid interest amounting to 2.5% for small-volume and 1.1% for large-volume loans in the short-term segment, while interest on long-term loans stood at 1.8% and 1.6%, respectively, of late. The surveyed banks reported that they had left their credit standards for lending to enterprises virtually unchanged.

The BLS conducted in July contained additional questions on banks' financing conditions, the impact of regulatory and supervisory activities relating to requirements for capital adequacy, leverage ceilings or liquidity, as well as the banks' participation in the TLTRO I and TLTRO II operations. Against the backdrop of conditions in the financial markets, German banks reported a marginal improvement in their funding situation compared with the previous quarter. With regard to regulatory and supervisory activities, the first half of 2017 saw the banks reducing their risk-weighted assets further, on balance, and strengthening their capital position again. The fourth and final TLTRO II in March 2017 met with greater interest among the surveyed credit institutions than the previous TLTRO I and TLTRO II operations. They put their participation down to the attractive conditions of the operations. Reportedly, the borrowed funds were to be used chiefly for lending, in keeping with the objective of the monetary policy measure. Overall, the participating banks' financial situation improved markedly, although participation itself had no impact on their credit standards.

German BLS banks show greater interest in final TLTRO II operation