

Monetary policy and banking business

Monetary policy and money market developments

ECB Governing Council leaves policy rates unchanged

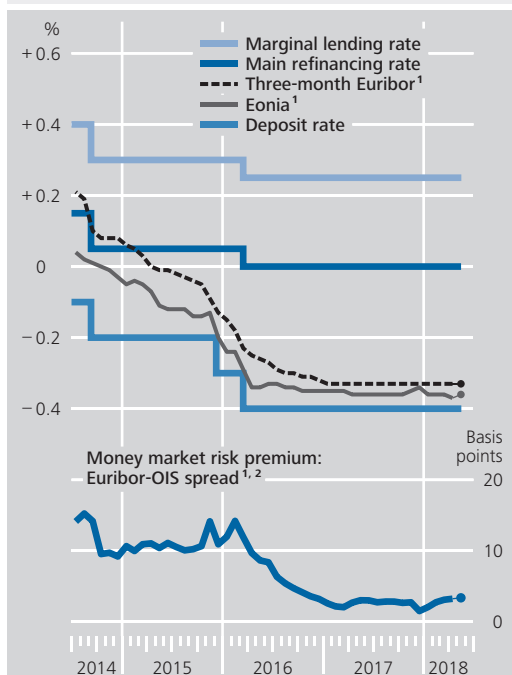
Based on its economic and monetary analysis, the ECB Governing Council kept key interest rates unchanged in the reporting period. The main refinancing rate thus remains at 0%, while the marginal lending rate stands at 0.25% and the deposit facility rate at -0.40%. The Governing Council continues to expect the key interest rates to remain at their present 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) will be made at the monthly pace of €30 billion net until the end of September 2018, 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. Redemption

amounts will be reinvested alongside the net purchases. The Eurosystem will reinvest the principal payments from maturing securities for an extended period of time after ending net asset purchases, and in any case for as long as necessary.

At its meeting in March 2018, the Governing Council decided to remove from its communication what had thus far been an explicit statement that it would potentially increase or extend the monthly purchases under the APP. This statement had been introduced in December 2016 and was linked to a deterioration in the economic outlook or in financing conditions, which would otherwise no longer have been in line with further progress towards a sustained adjustment in the path of inflation. In so doing, the Governing Council adjusted its communication to reflect the considerably improved economic situation and its growing confidence in the path of inflation.

ECB Governing Council adjusts monetary policy communication

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 May 2018.

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After several quarters of economic growth being higher than expected, the data received since the March meeting suggest a slight slowdown in economic growth since the beginning of 2018. This is probably indicative, at least in part, of a normalisation in the underlying cyclical trend. According to the Governing Council, this development continues on the whole to be consistent with the strong and broad-based growth momentum in the euro area. This growth outlook supported the Governing Council's confidence that inflation will converge towards its aim of below, but close to, 2%. However, domestic price pressures remain subdued, and the Governing Council has not yet identified any convincing signs of a permanent, self-sustaining upward trend. Overall, the ECB Governing Council therefore concluded that a high degree of monetary policy accommodation remains necessary to

Continued strong and broad-based economic growth momentum

Money market management and liquidity needs

The two reserve maintenance periods between 31 January 2018 and 2 May 2018 saw a significant increase in euro area liquidity needs stemming from autonomous factors (see the table below). Levels were high in the March-May 2018 reserve period, averaging €1,275.1 billion. This was €87.6 billion more than in the December 2017-January 2018 reserve period, ie the last period before the period under review, and constituted an increase of around €275 billion against the corresponding period in 2017. Overall, the sum of the autonomous factors moved within a broad corridor of between €1,152.3 billion and €1,343.2 billion in the two reserve maintenance periods. The main factor behind the average increase in liquidity needs stemming from autonomous factors against the December 2017-January 2018 reserve period was the net €70.9 billion aggregate decline in net foreign assets and other factors, which are considered together on account of liquidity-neutral valuation effects. In addition, the in-

crease both in government deposits with the Eurosystem and the volume of banknotes in circulation raised the calculated need for central bank liquidity by an average of €15.1 billion and €1.6 billion respectively. In the March-May 2018 reserve period, average government deposits were high, at €247.5 billion, while banknotes in circulation in the Eurosystem averaged €1,159.0 billion. The minimum reserve requirement was €124.4 billion in the March-May 2018 reserve period (previous year: €120.6 billion), which equated to a liquidity-absorbing increase totalling €1.0 billion across the two reserve maintenance periods.

There was little overall change in liquidity provision from refinancing operations. In the period under review, the option of voluntary early repayment was available for four of the targeted longer-term refinancing operations from the first series (TLTRO I), allowing the participating institutions to cut the original

Factors determining banks' liquidity*

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

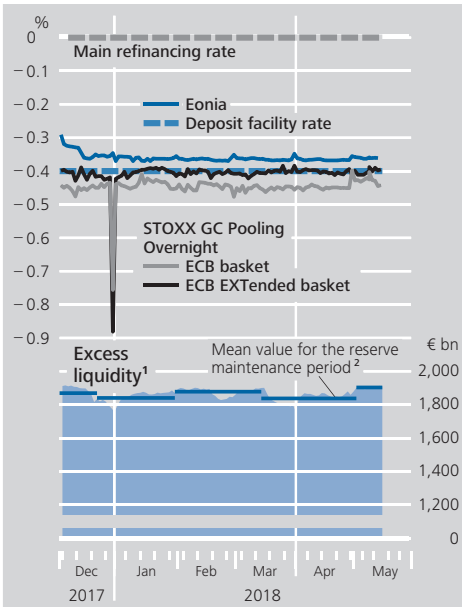
Item	2018	
	31 January to 13 March	14 March to 2 May
I Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors		
1 Banknotes in circulation (increase: –)	– 11.6	+ 10.0
2 Government deposits with the Eurosystem (increase: –)	+ 0.4	– 15.5
3 Net foreign assets ¹	+ 1.2	– 4.8
4 Other factors ¹	– 79.4	+ 12.1
Total	– 89.4	+ 1.8
II Monetary policy operations of the Eurosystem		
1 Open market operations		
(a) Main refinancing operations	– 0.1	– 1.4
(b) Longer-term refinancing operations	– 3.1	– 0.1
(c) Other operations	+ 64.7	+ 37.3
2 Standing facilities		
(a) Marginal lending facility	+ 0.0	– 0.2
(b) Deposit facility (increase: –)	– 6.7	+ 2.9
Total	+ 54.8	+ 38.5
III Change in credit institutions' current accounts (I + II)	– 34.5	+ 40.4
IV Change in the minimum reserve requirement (increase: –)	– 0.9	– 0.1

* 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

Programme	Change across the two reserve periods	Balance sheet holdings as at 11 May 2018
Active programmes		
PSPP	+ 60.2	1,980.7
CBPP3	+ 8.2	253.3
CSPP	+ 15.3	153.6
ABSPP	+ 1.7	27.1
Completed programmes		
SMP	- 4.5	84.7
CBPP1	- 0.8	5.2
CBPP2	- 0.4	4.3

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maturities of those operations by six months. Nine institutions opted to take part, repaying a total of €0.9 billion, with the fifth TLTRO I of 30 September 2015 accounting for the lion's share of €0.6 billion. The net supply of liquidity from TLTRO I amounted to €13.4 billion on 2 May 2018. With a total volume of €739.2 billion, TLTRO II are by far more significant in terms of liquidity provision. On 2 May 2018, they accounted for 97% of the outstanding tender volume and their maximum maturity is

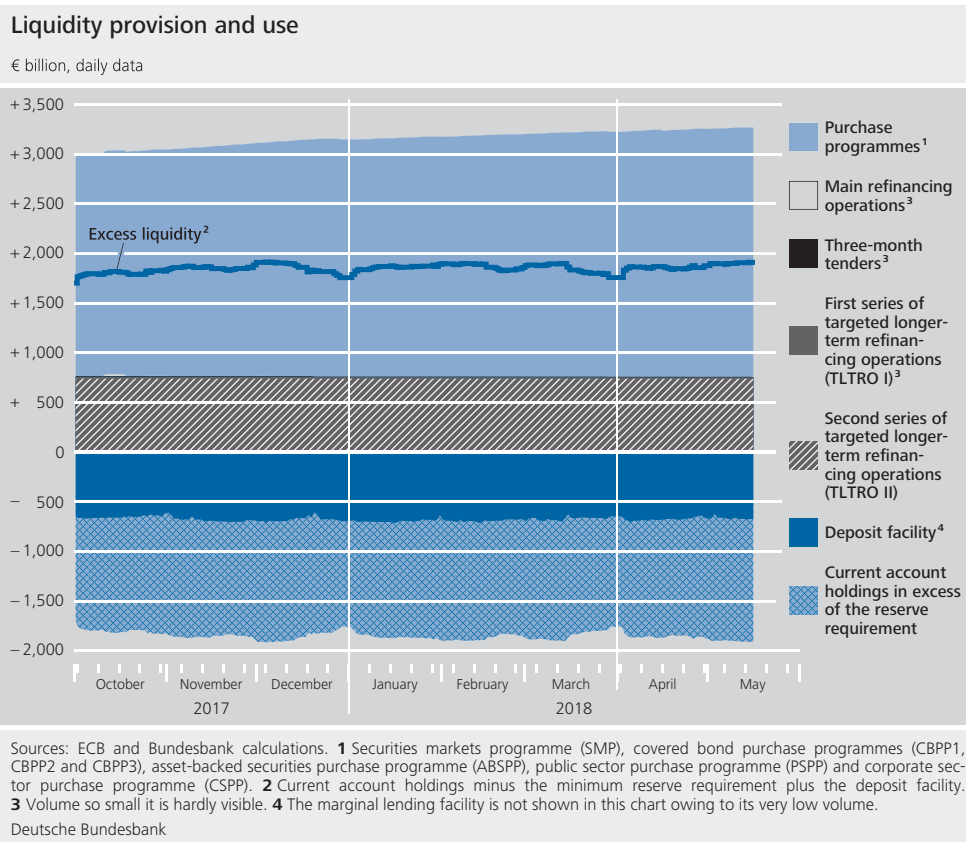
not due to end – in the case of the fourth TLTRO II – until March 2021 (see the chart on page 23).

In the light of the strong TLTRO effect and the very accommodative liquidity conditions, there continued to be scarcely any demand for the main refinancing operations; the volume shrank a further €1.0 billion against the December 2017-January 2018 reserve period, standing at an average of €1.9 billion for the March-May 2018 reserve period. Over the same timeframe, the total volume of the three-month tenders remained virtually unchanged at €7.7 billion. All in all, the outstanding tender volume barely changed, averaging €761.5 billion in the March-May 2018 reserve period (see the chart on page 24).

Monetary policy asset purchase programmes again accounted for the majority of the liquidity provided through the Eurosystem in the period under review. During the March-May 2018 reserve period, they represented average balance sheet holdings of €2,477 billion, which equated to a plus of €79 billion relative to the average balance sheet holdings of all purchase programmes in the December 2017-January 2018 reserve period (see the adjacent table).

On balance, there was a slight net decrease in excess liquidity in the Eurosystem owing to the marked increase in autonomous factors in the period under review, meaning that the injection of liquidity from the purchase programmes was not directly reflected in the excess liquidity. In the March-May 2018 reserve period, excess liquidity averaged €1,838 billion, which was €3 billion less than the average for the December 2017-January 2018 reserve period.

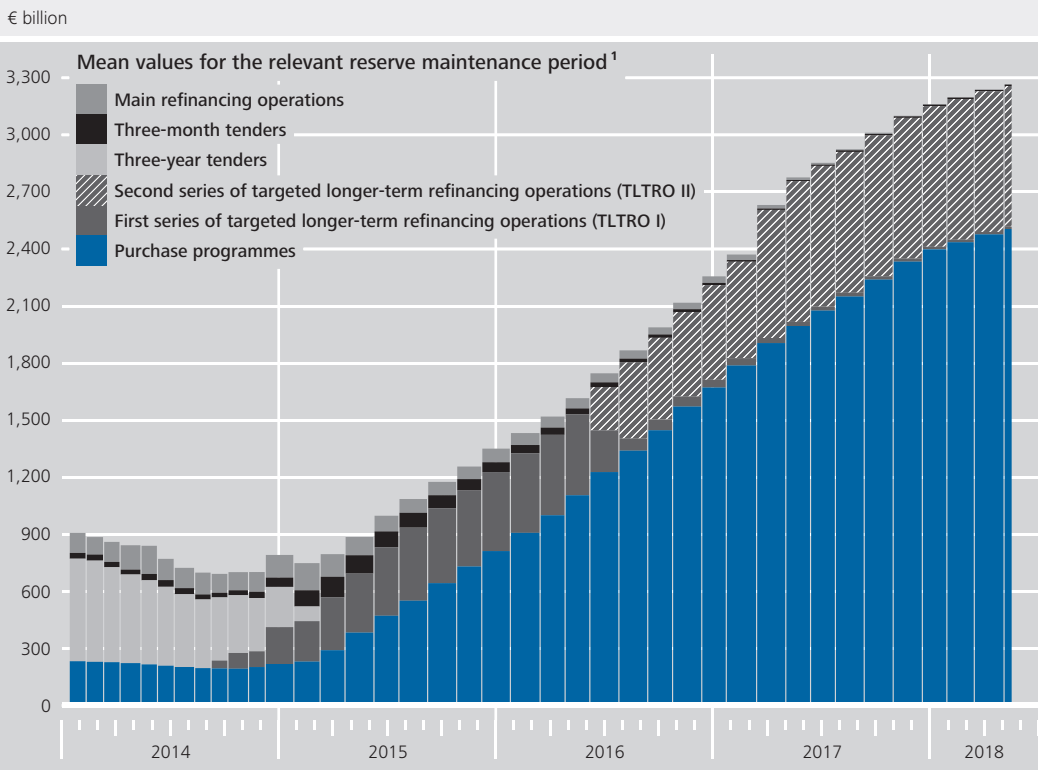
Against the backdrop of this very comfortable liquidity situation, the deposit facility rate remained the benchmark for overnight rates during the period under review (see the chart above). Eonia continued to move just above the deposit rate, despite the gap narrowing slightly. Across both of the observation periods, Eonia stood at an average of -0.36%,



ie 1 basis point lower than the average for the two previous reserve maintenance periods. Comparing averages for the same periods, the underlying turnover decreased by €0.2 billion to €5.1 billion. By contrast, secured overnight money in GC Pooling still mostly traded below the deposit facility rate. In the period under review, the average interest rate in the ECB basket stood at -0.45%, matching the average of both preceding reserve maintenance periods. In the ECBEXTended basket, with its larger set of eligible securities, the average interest rate was -0.40%, having averaged -0.41% in the two previous reserve maintenance periods. As in the case of the two preceding periods, the aggregate turnover across both baskets totalled an average of €5.4 billion over the two reserve maintenance periods, placing it at roughly the same level as Eonia turnover. However, volumes in the ECB basket saw somewhat larger fluctuations, rising from an average of €1.9 billion per trading day for the January-March 2018 reserve period to €3.1 billion in the March-May 2018 reserve period.

There were virtually no major changes in overnight rates at the end of each month in the two reserve maintenance periods. Against a backdrop of lower turnover volumes, Eonia mostly rose around 1 basis point. By contrast, the overnight rates in GC Pooling in both baskets reacted inconsistently and, on those reporting days, were either above or below the respective previous day's rate. The most pronounced deviation in the period under review was observed at the close of April 2018, when the rate in the ECB basket rose by 5 basis points to -0.40% – though turnover was very low. By comparison, this rate had fallen by 32 basis points to -0.76% at year-end 2017.

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



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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ensure a sustained return of the inflation rate to a level of below, but close to, 2%.

Purchase volumes still in line with announced target

On 16 May, the Eurosystem held assets in the amount of €1,981.5 billion under the public sector purchase programme (PSPP). The average residual maturity of the PSPP portfolio fell yet again slightly from previously 7.7 years to a maturity of 7.6 years at present. The outstanding amounts acquired to date under the third covered bond purchase programme (CBPP3) and the asset-backed securities purchase programme (ABSPP) came to €253.5 billion and €27.4 billion respectively. As for the corporate sector purchase programme (CSPP), asset purchases totalled €154.5 billion by 16 May.

Growth in excess liquidity slows down slightly

Excess liquidity increased only slightly in the period under review. Overall, excess liquidity grew by €13 billion to €1,913 billion. The subdued increase reflects the significantly higher level of autonomous factors in the

period under review, which compensated for the liquidity supply from the reduced monthly purchases of €30 billion under the APP since January 2018. The volumes in the standard tender operations rose slightly in the same period, but remained at a very low level. Whether or not excess liquidity levels will record another strong increase in the course of 2018 due to the planned purchases under the APP until September this year could partly depend on the extent to which autonomous factors saw only temporary strong growth and on the amount of the voluntary repayments under the second series of targeted longer-term refinancing operations (TLTRO II), which are possible from the end of June 2018.

In the reporting period, the unsecured overnight money market rate (Eonia) hovered in a narrow range of between -0.36% and -0.37%, above the deposit facility rate of -0.40%, while the secured overnight rate (STOXX GC Pooling) remained slightly below

Money market interest rates virtually unchanged overall

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

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

Assets	2018 Q1	2017 Q4	Liabilities	2018 Q1	2017 Q4
Credit to private non-MFIs in the euro area	111.5	87.8	Holdings against central government ²	- 16.6	- 9.2
Loans	99.8	75.3	Monetary aggregate M3	80.4	84.9
Loans, adjusted ¹	96.6	92.8	of which Components		
Securities	11.7	12.4	Currency in circulation and overnight deposits (M1)	102.6	116.9
Credit to general government in the euro area	- 39.2	89.4	Other short-term deposits (M2-M1)	- 13.4	- 11.4
Loans	- 10.4	- 16.3	Marketable instruments (M3-M2)	- 8.8	- 20.6
Securities	- 28.7	105.5	Longer-term financial liabilities of which	8.2	- 36.1
Net external assets	57.0	- 77.1	Capital and reserves	15.6	- 5.2
Other counterparts of M3	- 57.4	- 60.2	Other longer-term financial liabilities	- 7.4	- 30.9

* 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. ² Including central government deposits with the MFI sector and securities issued by the MFI sector held by central governments.

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the deposit facility rate. The three-month Euribor was largely unchanged throughout the reporting period, standing at -0.33% at last report.

Money market forward rates, too, moved in a narrow range in the period under review, recording a slight decrease overall. At the same time, the expectations priced in by the markets about the future interest rate path remained largely unchanged. At the current end, markets are pricing in an interest rate hike of 15 basis points for the beginning of the third quarter of 2019.

Monetary developments in the euro area

As in the fourth quarter of 2017, the growth of the broad monetary aggregate M3 in terms of counterparts was driven mainly by the ongoing recovery of loans to the non-financial private sector in the quarter under review. Against the backdrop of the economy's broad-based growth path, both loans to non-financial corporations and loans to households continued to post strong inflows. The persistently buoyant demand for credit was also supported by the still very low interest rate level. In addition, the banks reporting to the

Bank Lending Survey (BLS) stated that they had further eased their lending policies in all credit segments surveyed in the quarter under review.

Despite the ongoing upward trend in lending, the annual growth rate of M3 in the reporting quarter fell from 4.6% at the end of December to 3.7% at the end of March. Taken in isolation, the decline in the MFI sector's securitised lending to general government, above all, had a dampening effect on monetary growth; this was linked to the Eurosystem further reducing the monthly purchase volumes under the APP from January. In addition, monetary capital for the first time since 2011 again recorded net inflows in the reporting period. All in all, the declining importance of these counterparts of M3, in particular, caused the gap between monetary growth and the growth of loans to the private sector, which had risen to up to 5 percentage points in the wake of the sovereign debt crisis and the non-standard monetary policy measures, to drop to below 1 percentage point in annual terms.

The dominant force behind monetary growth in the reporting quarter, too, was the increase in overnight deposits. However, the growth in overnight deposits compared with the already weak previous quarter once again dropped perceptibly. From a sectoral perspective,

Overnight deposits still dominant force behind M3 growth

Policy rate expectations largely unchanged

Monetary dynamics increasingly driven by loan growth

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. **4** Including non-profit institutions serving households.

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non-monetary financial corporations even saw significant outflows from overnight deposits, which are likely, *inter alia*, to be related to the reduction in bond sales by this sector to the Eurosystem. By contrast, maintaining money holdings remained attractive for risk-averse investors, with both households and non-financial corporations recording further strong inflows to overnight deposits. Moreover, given the persistently low interest rate spreads between deposit types, the shifts observed for some time now from time deposits to more liquid short-term savings and overnight deposits continued.

In terms of counterparts, monetary growth in the first quarter of 2018 was mainly supported by the further expansion in lending by the MFI sector to the non-financial private sector. The biggest contribution in this quarter took the form of loans to households, which continued on their steady growth path; primarily banks in Germany and France, but also in Italy, contributed to this development. The expansion of this particular credit aggregate was again mainly down to loans for house purchase. According to the assessment made by the banks surveyed in the BLS, household demand for loans for house purchase increased slightly again in the first quarter of 2018. 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 housing market as explanatory factors for the rising need for funds. Effects pushing down demand were mainly the result of loans extended by competitors and households' use of their own savings to help fund house purchases. On balance, credit standards in this segment were eased markedly. According to the information provided by the banks, the easing essentially occurred against the backdrop of the high level of competition in the banking and non-banking sectors, the more positive assessment of the economic situation and outlook as well as an improved risk assessment of borrowers' creditworthiness.

Continued growth in loans to households, again driven by loans for house purchase

In addition, dynamic growth in consumer credit persists

Consumer credit continued to grow strongly in the reporting period and thus remained the most dynamic component of loans to households. The persistently high inflows probably reflect the ongoing expansionary underlying trend in private consumption. This is consistent with the fact that households' need for consumer credit posted another noteworthy increase in the first quarter of 2018, according to the results of the BLS. Respondents put the higher demand down to stable consumer confidence, the low general level of interest rates, and the high propensity to purchase. On balance, credit standards were loosened marginally.

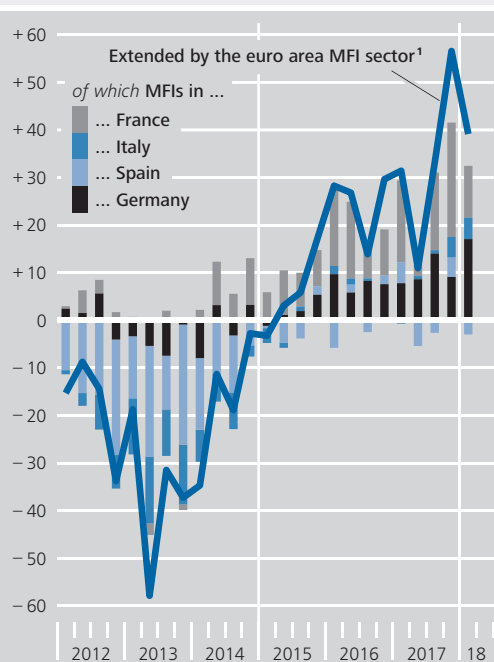
Loans to non-financial corporations record distinct rise, too

In the quarter under review, loans to non-financial corporations in the euro area experienced distinct growth as well. Growth stimuli continued to emanate mainly from banks in Germany and France, and – albeit to a lesser extent – from Italy, in addition to a number of smaller core countries (see the adjacent chart). The annual growth rate of the euro area aggregate (adjusted for securitisation and other one-off effects) increased to 3.3% at the end of March, ie almost one percentage point higher than a year earlier. The continued increase in loans to enterprises was supported by the strong and broad-based economic growth across euro area member states over the past few quarters. Further supporting factors came in the form of lending rates, which remained close to their historical lows throughout the euro area, and the high level of competition between banks.

This is consistent with the banks surveyed as part of the BLS reporting a marked increase in the demand for credit by non-financial corporations in the euro area as a whole. Although the increase was somewhat weaker compared with the significant rise in the fourth quarter of 2017, the dynamic development of the most recent survey rounds continued overall. Besides the low general level of interest rates, the bank managers mainly attributed this expansionary development to a higher

Loans to non-financial corporations in the euro area*

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



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

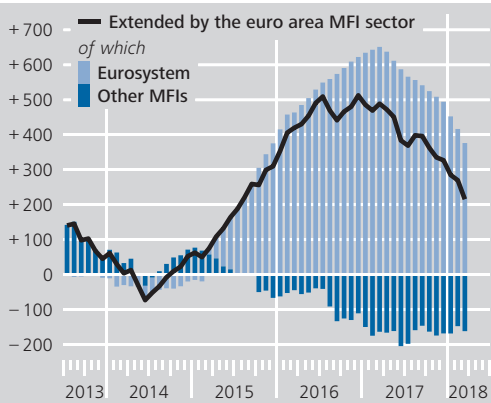
financing need for mergers, acquisitions and corporate restructuring, as well as for fixed investment. By contrast, as in the previous surveys, enterprises' use of internal financing had a dampening effect on demand when taken in isolation. The credit standards for loans to enterprises were eased moderately.

Next to loans, the increase in the MFI sector's net external asset position observed in the reporting quarter constituted the second pillar of monetary growth. Net external assets thus continued the upward trend seen since the beginning of 2017. One reason for the positive development of this counterpart was foreign investors' higher demand for euro area securities. In the last few quarters, foreign investors scaled back their sales of euro area government bonds while increasing their purchases of euro area shares and mutual fund shares, in some cases significantly. The further reduction in the Eurosystem's monthly purchases since the beginning of this year is

Net external asset position characterised less by Euro-system asset purchases

Securities-based lending to general government in the euro area

€ billion, 12-month accumulated flows



Sources: ECB and Bundesbank calculations.
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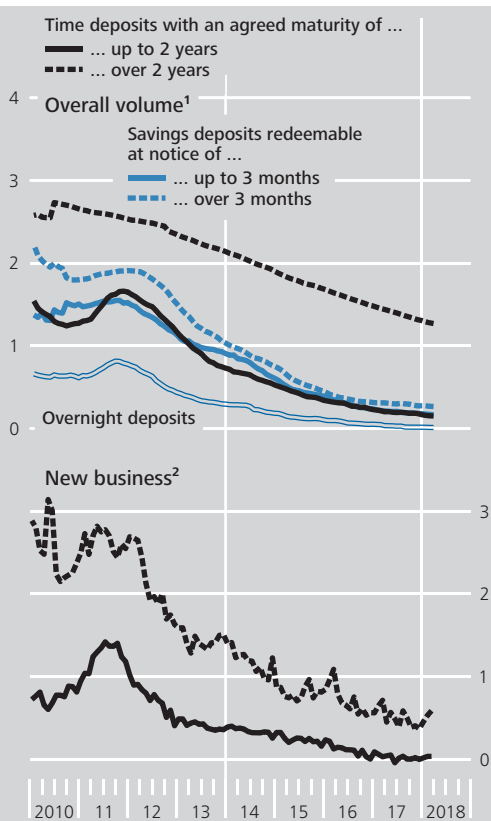
likely to have resulted in the demand for euro area securities by non-resident investors rising on balance.

Moreover, the reduction of net purchases under the APP was one of the key reasons behind securitised lending by the MFI sector to general government in the euro area losing even more significance in the quarter under review (see the adjacent chart). This effect was aggravated by the fact that the Eurosystem central banks reduced their government bond purchases disproportionately. In addition, commercial banks once again significantly lowered their holdings of government bonds in the reporting quarter (in seasonally adjusted terms), meaning that securities-based lending by the MFI sector to general government even declined on the whole.

Reduced securitised lending, inter alia due to the Eurosystem halving its monthly APP net purchases, dampens M3 growth

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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A *per se* dampening effect on monetary growth also emanated from monetary capital, where slight net inflows were recorded in the reporting quarter. Besides institutions' capital and reserves, longer-term bank debt securities in the hands of the money-holding sector likewise rose for the first time since 2013. One reason could be that this type of financing is gradually becoming more attractive again to banks given that the Eurosystem no longer offers multi-year tenders. Furthermore, non-banks are also likely to be finding this type of investment increasingly attractive due to the temporary hike in yields.

Monetary capital inflows dampen monetary growth

German banks' deposit and lending business with domestic customers

Between January and March 2018, domestic investors continued to make substantial deposits with German banks. Recent growth was once again fuelled by overnight deposits, which, despite negative interest rates in some cases, again saw significant build-up in the quarter under review. Short-term time deposits and long-term bank deposits, by contrast, were reduced again in net terms. This meant that the

Deposit growth again dominated by build-up of overnight deposits

investment behaviour of the money-holding sectors in Germany remained unchanged in its underlying trends and was strongly influenced by low interest rates (see the chart on page 28) and the flat yield curve also in the quarter under review.

Households continue to make largest contribution to build-up of overnight deposits

Growth in overnight deposits was again mainly fuelled by households (see the box on pages 30 to 33), but non-financial corporations also recorded inflows in the quarter under review, despite the fact that, in some cases, interest rates on overnight deposits fell deeper into negative territory. However, at the same time, non-financial corporations reduced large amounts of short-term time deposits, meaning that the increase in deposit business with this sector was only slightly positive as a whole.

Financial corporations' investment behaviour still fuelled by search for yield

Financial corporations, whose investment behaviour is traditionally characterised more strongly by return considerations, once again had a negative impact on deposits in net terms. In the quarter under review, too, this was primarily due to insurance corporations and pension funds, which again made significant reductions in their long-term bank deposits. This reflects the portfolio shifts that have been characteristic of these enterprises for quite some time now. Alongside the search for forms of investment with better yields, these shifts are also attributable to regulatory requirements (introduction of Solvency II). These provisions reinforce the incentive to hedge risks – which, in the case of insurance corporations, arise from the generally long maturities of their liabilities – by investing, wherever possible, in long-term assets at matching maturities and thereby aligning the maturities of their assets and liabilities (see also the box on pages 30 to 33).

Expansion of lending business with domestic non-banks weaker than in previous quarter due to general government ...

In contrast to deposit business, growth in loans from German banks to domestic non-banks slowed substantially in the quarter under review. The main cause of this was the continued fall in credit to general government, which steepened again in that quarter. This

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

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

Item	2017	2018
	Q4	Q1
Deposits of domestic non-MFIs¹		
Overnight	31.4	34.1
With an agreed maturity of		
up to 2 years	- 7.7	- 1.2
over 2 years	- 1.7	- 4.7
Redeemable at notice of		
up to 3 months	- 0.3	0.3
over 3 months	- 2.3	- 1.6
Lending		
to domestic general government		
Loans	- 1.4	- 10.3
Securities	- 6.9	- 8.9
to domestic enterprises and households		
Loans ²	22.9	32.0
of which to households ³	12.6	17.2
to non-financial corporations ⁴	9.9	12.5
Securities	5.4	- 5.9

* 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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development particularly reflects the further decline in the financing needs of the public sector, which is not especially surprising given the considerable surpluses in government budgets overall.

By contrast, lending business with the domestic private sector grew to a similar extent as in the previous quarters. Although the banks markedly reduced their securities holdings from private issuers for the first time in seven quarters, at the same time they again increased their lending to the private sector to a greater degree than in the previous quarter.

... but renewed expansion in lending to domestic private sectors

Acquisition of financial assets and the search for yield in Germany

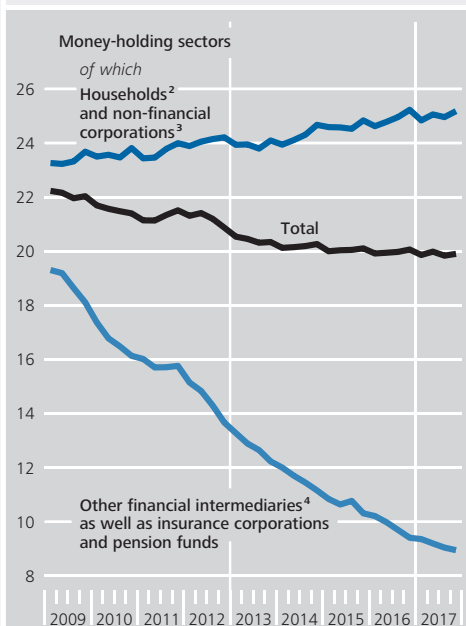
The development of the acquisition of financial assets by the individual sectors in Germany has already been the subject of the *Monthly Report* in previous years. The results suggested that the persistent low-interest-rate environment was having only a limited impact on the private non-financial sector's search for yield.¹ Though it gradually picked up in the years 2014 to 2016, the search for yield played a minor role in the acquisition of financial assets by households and non-financial corporations on the whole. Risk aversion and a preference for liquidity were the predominant drivers. In the case of financial corporations,² on the other hand, the search for yield featured comparatively strongly. Most of the sectors did not engage in large-scale portfolio shifts, however.

Overall, this investment behaviour remained evident in the most recent data (concerning 2017) from monetary statistics and financial accounts for the money-holding sectors in Germany. In particular, there was no indication of a substantial increase in the search for yield in that period. Such an increase could especially be expected if the share of bank deposits in investors' portfolios fell distinctly and preference were given to forms of investment which, on average, generated higher yields. In fact, the share of bank deposits moved sideways over the course of 2017. This was attributable, first, to a weaker build-up of deposits in the private non-financial sector and, second, to a slightly slower reduction in financial corporations' deposits (see the adjacent chart).

The development of bank deposits as a percentage of the total financial assets of the private non-financial sector was characterised by the fact that the build-up of households' deposits in 2017 fell somewhat behind the previous year's very high level. Nevertheless, deposits were still the most important form of investment. Once again, inflows were due mainly to the unusually strong build-up of overnight deposits, which are particularly liquid, amidst even tighter interest rate spreads between the different types of deposit. The second most important form of investment for households remained claims on insurance corporations. Combined with the persistently high level of importance of overnight deposits, this continues to indicate a pronounced aversion to risk on the part of households.

Deposits as a percentage of total sectoral financial assets in Germany

Notional stocks with base year 2000¹, %



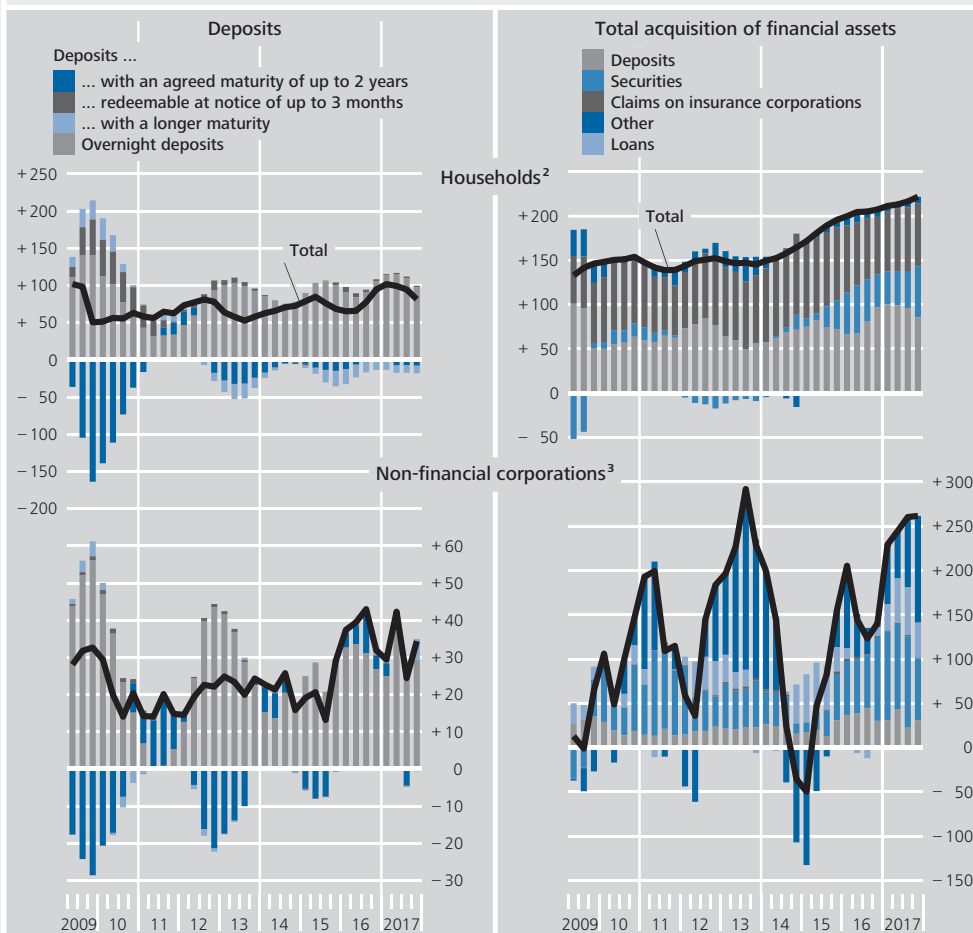
¹ To adjust for statistical changes and revaluations. ² Including non-profit institutions serving households. ³ Non-financial corporations and quasi-corporations. ⁴ Including investment funds. Deutsche Bundesbank

¹ See Deutsche Bundesbank, Ongoing portfolio shifts into higher-yielding assets in Germany, *Monthly Report*, May 2017, pp 30-33.

² For the purposes of this box, financial corporations are defined as excluding monetary financial institutions, 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.

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

€ billion, 12-month flows at quarter-end¹



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

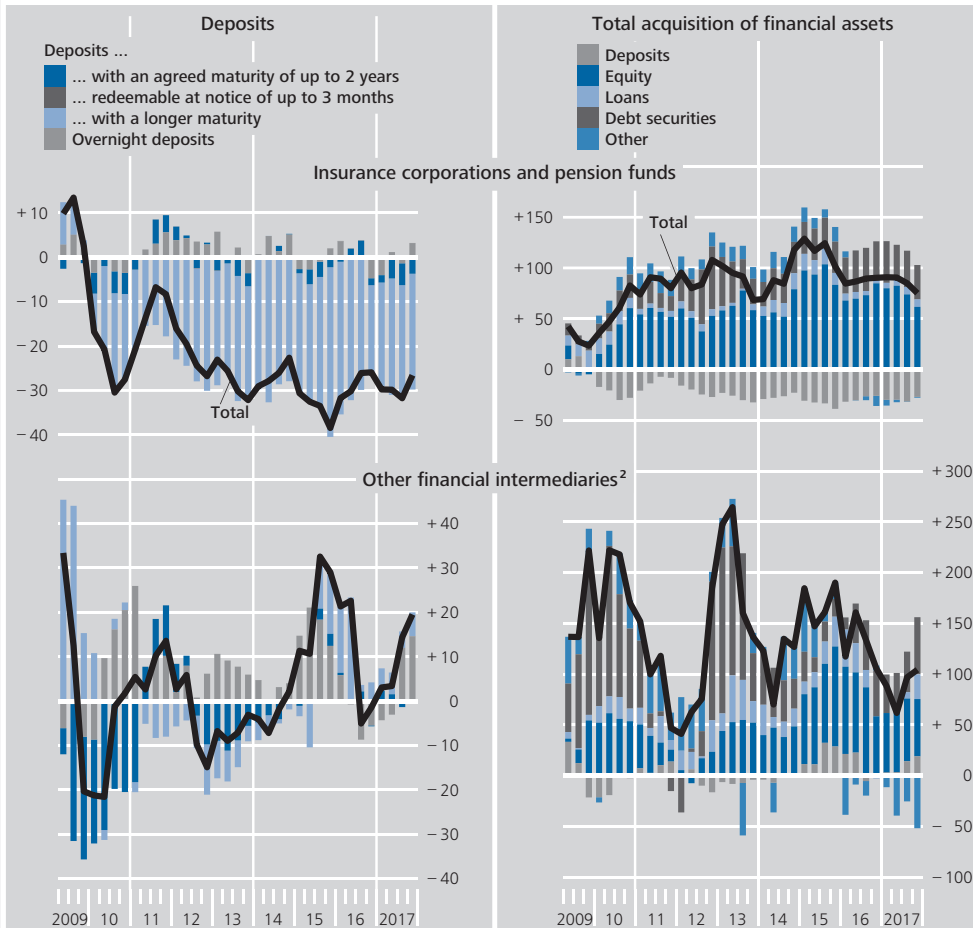
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However, the sector's capital market exposure rose clearly compared with the years 2007-14. This build-up was mainly driven by the acquisition of investment fund shares, which was considerably stronger in 2017 than in the year before. Households also purchased more listed shares issued outside the euro area. These developments suggest that households were increasingly basing their investment decisions on yield calculations, too, and often turned to indirect investment products that are managed by institutional investors and therefore more diversified.

The non-financial corporate sector again slightly accelerated the build-up of deposits already seen in the previous two years. Demand was mainly for overnight deposits, whereby the distribution of demand within the sector was mixed. Overnight deposits suffered a decline in attractiveness for many enterprises as banks again lowered overnight deposit rates across the board – and more sharply than for households – and in numerous cases pushed them into negative territory. Overall, however, the main factor was that a number of mostly larger enterprises showed a strong preference for secure and liquid assets as part of their liquidity management considerations, and they

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

€ billion, 12-month flows at quarter-end¹



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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were able to implement such investment strategies at adequate conditions despite the general low-interest-rate environment.³

A much larger role in non-financial corporations' acquisition of financial assets, which was very strong in 2017 on the whole, was played by the acquisition of securities – notably shares, purchases of which had not been as high since 2008. This is connected with the increase in equity investment, which recently picked up pace, not least abroad. In addition – following rather weak lending activity in 2016 – lending to other non-financial corporations in Germany and abroad is currently on the rise again, includ-

ing in some cases loans in a group context. All in all, yield considerations do not seem to be the sole driver behind the investment decisions of German non-financial corporations; corporate policy aspects also play a part, as does preference for secure and liquid investments.⁴

³ For more on the drivers of non-financial corporations' money holdings in selected countries, see Financial Stability Board, Corporate cash holdings as a demand factor for non-bank financial instruments, Global Shadow Banking Monitoring Report 2017, pp 79-84; and, on liquidity management in Germany, Deutsche Bundesbank, Long-term developments in corporate financing in Germany – evidence based on the financial accounts, Monthly Report, January 2012, pp 13-27.

⁴ See also Financial Stability Board, op cit.

In the financial sector, insurance corporations and pension funds have been scaling back their stock of bank deposits substantially since 2010. Once again, they mostly reduced longer-term time deposits. In so doing, German insurers – whose deposits as a percentage of total balance sheet assets were strikingly high in the past by euro area standards – gradually lowered their direct interconnectedness with the German banking sector, which is considered a particularly safe counterparty.⁵ Given the persistence of low interest rates, they instead gave preference to forms of investment with returns that enjoy more favourable treatment under commercial and tax law due to the possibility of retention of profits.⁶ Investment in investment fund shares was therefore high, as in previous years. Moreover, long-term debt securities issued by foreign sectors were also purchased in significant quantities. The increasing share of these securities in relation to total assets reflects the efforts of insurance corporations to match the maturities of their assets with those of their largely long-term liabilities. This should be seen against the backdrop of the persistently low level of interest rates and the new European supervisory regime for the insurance sector (Solvency II), which came into force in 2016.⁷

The other financial institutions⁸ raised their stock of deposits, which was relatively volatile over time, appreciably compared with the previous year. This growth was mainly attributable to inflows to overnight deposits of investment funds, which are heavily dependent on the reporting date, and long-term time deposits of financial vehicle corporations (FVCs).⁹ Besides the rise in deposits, credit claims of other financial institutions on the private non-financial sector likewise saw an increase. This was also related, in part, to securitisation activities. The purchase of securities accounted for the largest share of the total acquisition of financial assets by this sector, however. The main buyers here were investment funds,

which mainly acquired shares in other investment funds. In addition, they again stepped up their direct involvement in listed shares and long-term debt securities, particularly those from abroad. In so far as foreign investments entail increased risk, this is probably due, not least, to the continued expectation of higher yields.

On the whole, however, there is no indication that the money-holding sectors that were searching for yield took on a markedly higher level of risk than in the previous year. This applies, in particular, to the private non-financial sector, whose investment decisions continued to be guided by risk aversion and a preference for liquidity. However, the rise in investment by households in the capital market, including in foreign securities, shows that yield aspects were increasingly taken into account. The financial sector, which opted for higher-yielding forms of investment, extended the maturities of assets and stepped up investment abroad, likewise showed signs of a slightly intensified search for yield.

⁵ See Deutsche Bundesbank, Risks for insurers, pension institutions and investment funds, Financial Stability Review 2017, pp 83-101.

⁶ As is pointed out in Deutsche Bundesbank (2017), Financial Stability Review, op cit, this portfolio shift, which was perceptible in the aggregate, took place with a high degree of variation between the individual insurers, and was driven primarily by a handful of large life insurers.

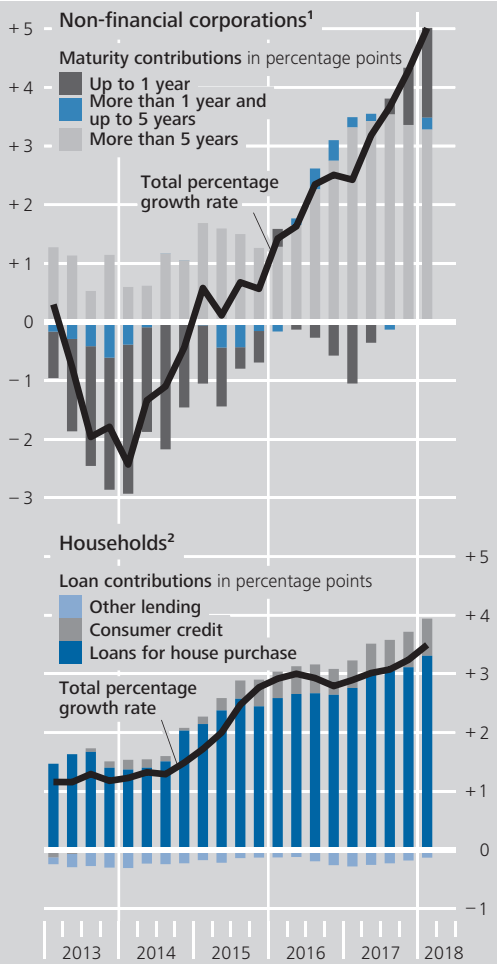
⁷ For more information, see Deutsche Bundesbank, Risks in the life insurance sector, Financial Stability Review 2015, pp 41-54, op cit; and D Domanski, HS Shin and V Sushko (2017), The hunt for duration: not waving but drowning?, IMF Economic Review, 65 (1), pp 113-153.

⁸ Including investment funds, but excluding monetary financial institutions and thus also money market funds.

⁹ The latter arise for accounting reasons following a net increase in securitisation transactions in the banking sector. If a bank securitises loans without removing them from its balance sheet, the transaction is booked according to the countervalue received by the bank from the financial vehicle corporation for those securitised loans, typically as a long-term liability of the bank to that FVC.

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. **2** Including non-profit institutions serving households.
 Deutsche Bundesbank

Persistently strong demand among households for housing loans and consumer credit

The largest contributors to the growth in loans were again households, whose demand for housing loans continued to rise significantly in the reporting quarter. The positive trend from the previous quarters also carried on in the case of consumer credit. Alongside the positive development in income and assets, households' demand for bank loans was encouraged by financing terms that remain exceptionally favourable. According to MFI interest rate statistics, interest rates for both housing loans and loans for private consumption remained close to their all-time lows in the reporting quarter despite slight upward adjustments.

The results of the latest BLS provide evidence of further factors influencing these developments. Banks indicated that the demand for private housing loans in the reporting quarter was more dynamic than in the preceding quarters. Respondents believed that this was caused by the positive outlook for the housing market and robust consumer confidence, in addition to the low general level of interest rates. Refinancing, restructuring and renegotiation also had a positive influence on demand. According to the survey, demand was dampened by increased use of own savings, amongst other factors. In the case of consumer credit, the banks largely attributed the rise in demand to households' stable propensity to purchase and robust consumer confidence.

Demand for housing loans and consumer credit was also supported by a further easing of lending policies. The banks surveyed as part of the BLS stated that, for the third time in succession, they somewhat eased credit standards for private housing loans in the first quarter of 2018 and also have plans to loosen standards further in the second quarter. As in previous quarters, credit terms and conditions agreed in loan contracts were also eased as a whole by the banks. However, unlike in previous quarters, this only affected margins; the other surveyed conditions remained unchanged.

Lending policies in the areas of private construction and consumer credit support demand overall

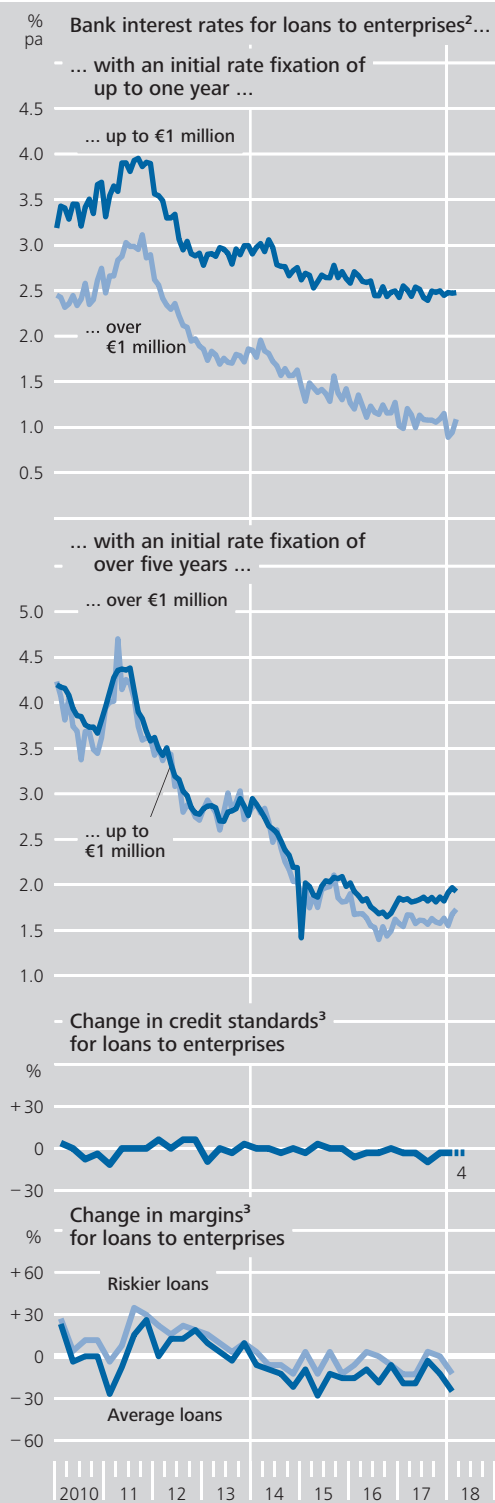
In the case of consumer credit, too, credit standards were moderately eased and credit terms and conditions were adjusted to a significant extent overall. The banks attributed these adjustments to the high degree of competition as well as to their increased risk tolerance.

The other mainstay of lending business with the domestic private sector in the quarter under review was loans to non-financial corporations. The growth in this sector typically trails GDP growth by a few quarters, which explains why these enterprises – in line with the ongoing economic boom – once again significantly increased their demand for bank loans in the

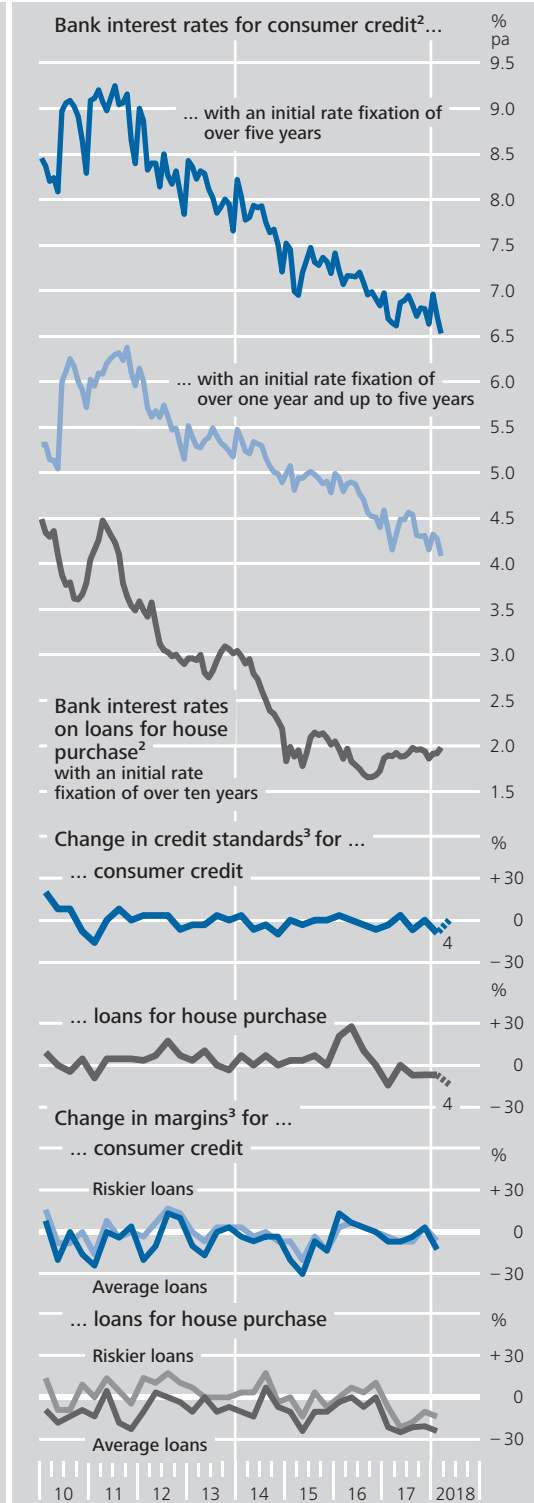
Increased interest in bank loans from non-financial corporations as well

Banking conditions in Germany

Credit to non-financial corporations



Credit to households¹



1 Including non-profit institutions serving households. **2** 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. **3** 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. **4** Expectations for 2018 Q2.

quarter under review. In addition to the continued high demand for long-term loans, short-term loans were also taken out in larger volumes, as had already been observed in the last few quarters. One possible reason for this is the interest rate spread, which widened slightly in favour of short-term loans. Overall, however, financing terms on the credit market remained favourable. For example, at the end of March, 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 1.9% and 1.7% respectively of late.

From the perspective of the banks surveyed in the BLS, the high financing needs of non-financial corporations for fixed investments as well as for refinancing, restructuring, and renegotiation were key to the rise in demand for bank loans, while enterprises' use of internal financing and borrowing from other banks were the main factors dampening demand.

Credit standards in lending to enterprises eased markedly as a whole

Banks' credit standards also supported lending to enterprises in the reporting quarter. The minimum requirements that non-financial corporations must fulfil in order to be granted loans were marginally eased in net terms, and the credit terms and conditions were repeatedly loosened markedly. As well as narrowing margins, the banks made considerable concessions to their corporate customers with regard to loan maturities and also relaxed conditions concerning covenants, credit amounts as well as non-interest rate charges.

The banks stated that intense competition was one of the key reasons for easing their lending policies in the corporate financing sector.

The April BLS survey contained additional questions on banks' financing conditions, the current levels of credit standards, the impact of the Eurosystem's expanded APP, 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 showed very little change 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 are currently somewhat looser, whereas the current standards for housing loans are considerably tighter and standards for consumer loans are at the same level. With regard to the Eurosystem's expanded APP, the banks reported, on the one hand, further improvements in their liquidity position and financing conditions. On the other hand, the programme also continued to place a strain on their profitability. The negative interest rate on the deposit facility likewise contributed considerably to the decline in banks' net interest income over the past six months and, taken by itself, also led to falling lending rates and shrinking margins. At the same time, the negative interest rate on the deposit facility, viewed in isolation, led to a slight increase in the volume of loans to households, yet had no impact on loans to enterprises.

Banks' profitability dented by APP and negative deposit facility rate