Monetary policy and banking business

Monetary policy and money market developments

ECB Governing Council recalibrates pandemic emergency purchase programme

At the December 2020 monetary policy meeting, the Governing Council of the European Central Bank (ECB) recalibrated its monetary policy measures in view of the economic fallout from the resurgence of the coronavirus pandemic, increasing the envelope of the pandemic emergency purchase programme (PEPP) by €500 billion to a total of €1,850 billion and extending the horizon for net purchases under the PEPP to at least the end of March 2022. In any case, the Governing Council will conduct net purchases until it judges that the coronavirus crisis phase is over. Purchases are being conducted flexibly on the basis of market conditions and with a view to preventing a tightening of financing conditions that is inconsistent with countering the downward impact of the pandemic on the projected path of inflation. If favourable financing conditions can be maintained with asset purchase flows that do not exhaust the envelope, the envelope need not be used in full. Equally, the envelope of the PEPP can also be increased if necessary. The reinvestment of principal payments from maturing securities purchased under the PEPP was extended until at least the end of 2023.

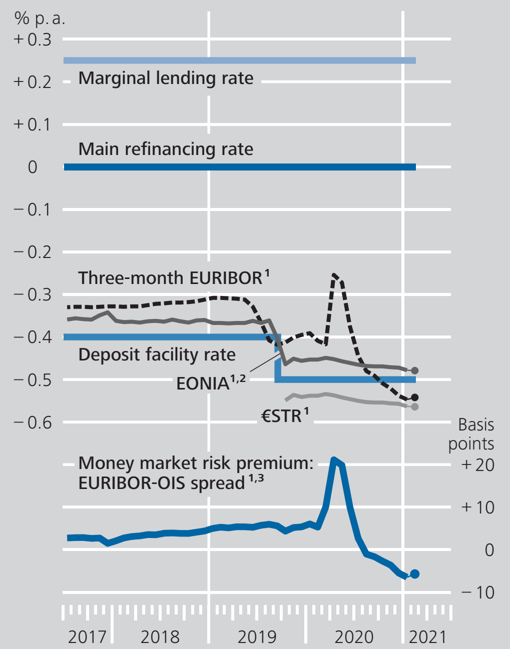
APP and key interest rates unchanged

The Governing Council left the asset purchase programme (APP) and the key interest rates unchanged. Net purchases under the APP will continue at a monthly pace of €20 billion. The main refinancing rate remains at 0%, while the rate on the marginal lending facility stands at 0.25% and the deposit facility rate at -0.5%.

ECB Governing Council adjusts refinancing operations

The ECB Governing Council decided to further recalibrate the conditions of the third series of targeted longer-term refinancing operations (TLTRO-III). Specifically, it decided to extend the period over which considerably more favourable terms will apply by 12 months, to June 2022. Three additional operations will also be conducted between June and December 2021. Moreover, the Governing Council raised the total amount that counterparties will be entitled to borrow in TLTRO-III operations from 50% to 55% of their stock of eligible loans. In order to provide an incentive for banks to sustain the current level of bank lending, the recalibrated TLTRO-III borrowing conditions will be made available only to banks that achieve a new lending performance target.[1] Moreover, the Governing Council also decided to offer four additional pandemic emergency longer-term refinancing operations (PELTROs) in 2021 with unchanged conditions and maturities of approximately one year. The Governing Council also announced that it would continue conducting its regular lending operations as fixed

Money market interest rates in the euro area



Sources: ECB and Bloomberg. 1 Monthly averages. 2 From 1 October 2019, EONIA calculated as €STR + 8.5 basis points. 3 Three-month EURIBOR less three-month EONIA swap rate. • Average 1 to 18 February 2021.
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1 For more details on the modalities of these operations, see European Central Bank (2020).

Money market management and liquidity needs

In the two reserve maintenance periods under review running from 4 November 2020 to 26 January 2021, liquidity needs stemming from autonomous factors fell by €37.7 billion to €1,889.5 billion (see the table below).[1] This development was attributable to a clear decline in government deposits with the Eurosystem, although all other autonomous factors each had a liquidity-absorbing effect. At an average of €530.3 billion in the December 2020-January 2021 period, government deposits, which had been rising very sharply since the second quarter of 2020 in the wake of the coronavirus pandemic (see the chart on p. 25), were €218.7 billion below the average for the September-November 2020 period. Lower government deposits with the Bundesbank – down by €65.3 billion to €189.4 billion – accounted for 30% of this decline. In comparison, the volume of banknotes in circulation in the Eurosystem rose significantly by €40.3 billion to an average of €1,429.4 billion. Cumulative net banknote issuance by Germany increased by €14.9 billion to €819.5 billion. Changes in net foreign assets and other factors, which are considered together owing to liquidity-neutral valuation effects, ultimately gave rise to an additional need for liquidity of €140.7 billion in the period under review. This development was mainly driven by a considerable rise in liabilities to non-euro area residents denominated in euro, stemming to a large degree from higher deposits from foreign central banks at the end of 2020. The

1 Average of the eighth reserve maintenance period of 2020 (December 2020-January 2021) compared with the average of the sixth reserve maintenance period of 2020 (September-November 2020), which was covered in the November 2020 issue of the Monthly Report. This comparative approach is also used for the individually cited autonomous factors.

Factors determining banks' liquidity*

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

Item	2020/2021 4 November to 15 December	16 December to 26 January
I. Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors		
1. Banknotes in circulation (increase: –)	– 14.8	– 25.5
2. Government deposits with the Eurosystem (increase: –)	+ 102.0	+ 116.7
3. Net foreign assets[1]	+ 0.7	– 16.5
4. Other factors[1]	– 34.2	– 90.7
Total	+ 53.7	– 16.0
II. Monetary policy operations of the Eurosystem		
1. Open market operations		
a) Main refinancing operations	– 0.8	– 0.2
b) Longer-term refinancing operations	+ 46.6	+ 38.2
c) Other operations	+ 138.9	+ 98.2
2. Standing facilities		
a) Marginal lending facility	0.0	0.0
b) Deposit facility (increase: –)	– 74.7	– 51.5
Total	+ 110.0	+ 84.7
III. Change in credit institutions' current accounts (I. + II.)	+ 163.7	+ 68.7
IV. Change in the minimum reserve requirement (increase: –)	– 0.4	– 1.4

* 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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rise in the minimum reserve requirement – by €1.9 billion to €14.5 billion in the December 2020-January 2021 period – also caused the need for central bank liquidity to increase. In Germany, the reserve requirement went up by €0.5 billion to €40.1 billion.

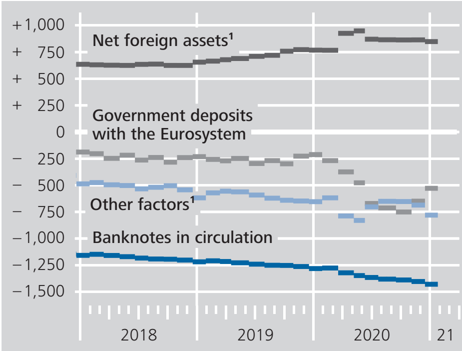
In the period under review, central bank liquidity was largely provided by purchase programmes, with a focus on the pandemic emergency purchase programme (see the chart on p. 27). However, at €50.4 billion, bids in the sixth operation of the third series of targeted longer-term refinancing operations (TLTRO-III) were lower than in previous operations. At the time when bids were submitted, it was not yet known that the Governing Council of the ECB would extend the period of favourable interest rates (for more information on the Governing Council's monetary policy decisions in December 2020, see pp. 23ff.). On balance, the sixth TLTRO-III operation as well as the maturities and repayments from TLTRO-II resulted in a net liquidity injection of €37 billion on 16 December 2020. Demand for pandemic emergency longer-term refinancing operations (PELTROs) was down for the sixth and seventh operations (to €2.6 billion in total). Interest in the regular main refinancing operations and three-month tenders likewise remained subdued. Total tender volume in the Eurosystem amounted to an average of €1,793 billion in the December 2020-January 2021 period. In Germany, the outstanding volume of longer-term operations – which include TLTROs, PELTROs and three-month tenders – rose by an average of €21.6 billion to €341.1 billion in the period under review, which represented a share of 19% in long-term tenders in the Eurosystem.

At an average of €3,713 billion, balance sheet holdings of the asset purchase programmes in the December 2020-January 2021 period were around €237 billion above the average for the September-November 2020 period (see also the table above).

In net terms, there was a considerable increase of €357 billion overall in excess liquidity in the period under review to an average of €3,471 billion. Whilst excess liquidity in the November-December 2020 period rose by €238 billion, it increased by a further €119 billion in the following December 2020-January 2021 period. The lower increase in the second period was above all due to seasonal effects, including higher deposits from foreign central banks

Autonomous factors in the Eurosystem*

€ billion, mean values for the relevant reserve maintenance period



Sources: ECB and Bundesbank calculations. * Liquidity-providing (liquidity-absorbing) factors are preceded by a positive (negative) sign. 1 Including end-of-quarter liquidity-neutral valuation adjustments.
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Eurosystem purchase programmes

€ billion

Programme	Change across the two reserve periods	Balance sheet holdings as at 12 February 2021
Active programmes[1]		
PSPP	+ 46.4	2,363.6
CBPP3	+ 1.4	289.0
CSPP	+ 11.6	258.6
ABSPP	− 0.7	28.9
PEPP	+ 165.3	837.4
Completed programmes		
SMP	+ 0.1	28.7
CBPP1	0.0	0.5
CBPP2	− 0.1	2.6

1 Changes due to net purchases, maturities, reinvestments and amortisation adjustments.
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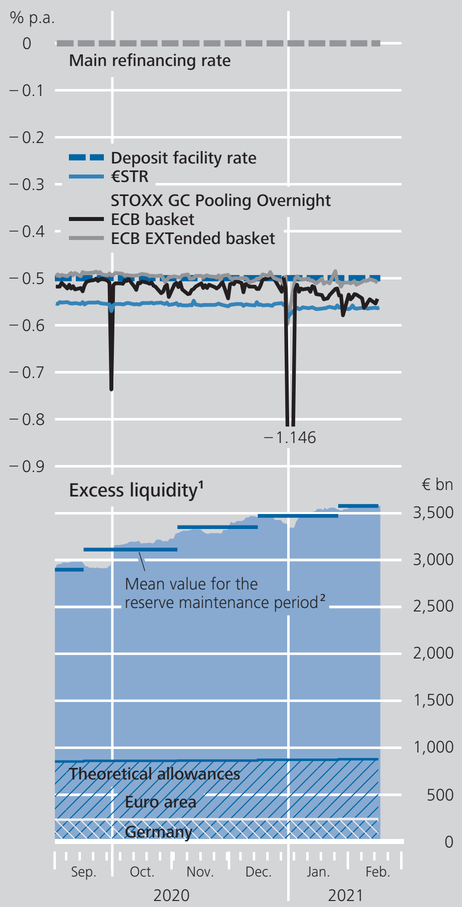
Central bank interest rates, money market rates and excess liquidity

Daily data



Sources: ECB, Eurex Repo and Bundesbank calculations. **1** Central bank balance minus the minimum reserve requirement plus the deposit facility. **2** The last period displayed is still ongoing.

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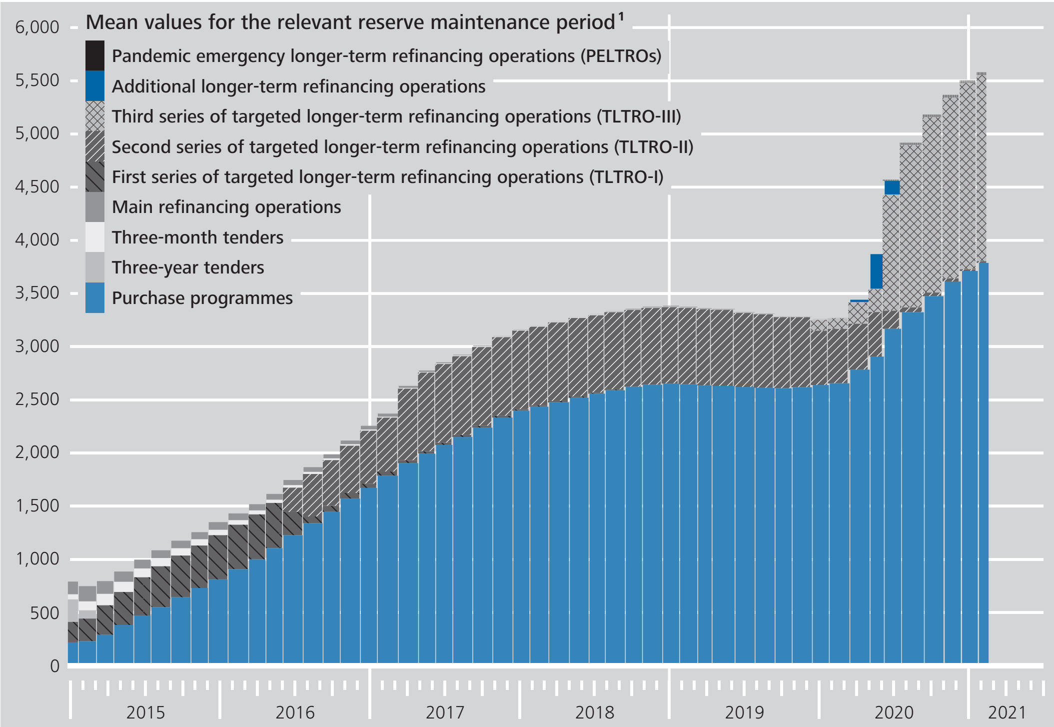
as well as lower purchase volumes in monetary policy programmes at year-end.

At 98.9%, Eurosystem banks made roughly the same use of the exemption allowances under the two-tier system for remunerating excess reserve holdings in the December 2020-January 2021 period as in the September-November 2020 period. In Germany, utilisation was still below the Eurosystem average and amounted to 98.5%, which was also close to the value recorded in the September-November 2020 period. The increase in the minimum reserve requirement caused the absolute exemption allowances to rise; however, given the much stronger growth in excess liquidity, excess reserves – remunerated at -0.50% – grew once again (see the adjacent chart). This meant that, on average, around 25% of excess liquidity in the Eurosystem was exempted from remuneration at negative interest rates in the December 2020-January 2021 period, compared with around 28% in the September-November 2020 period.

In the money market, interest rates fell slightly during the reporting period in the light of a continued increase in excess liquidity (see the adjacent chart). The secured market saw overnight rates in GC Pooling decline for the ECB basket, for the most part by 1 basis point to between -0.52% and -0.54%, although there was a significant decline to -1.15% with very low turnover at the end of 2020. While the rate for the ECB EXTended basket, which contains an extended pool of collateral, also fell marginally by around 1 basis point – with the exception of a sharper decline by 10 basis points to -0.60% at year-end – in the second half of January 2021, this rate generally stood at -0.51%. These developments should be seen in the context of a slight rise in turnover on the GC Pooling platform for secured transactions with maturities of one day (ON, TN, SN; combined in the Deferred Funding Rate). Over the timeframe from 1 January to the end of the period under review on 26 January 2021, turnover increased by around €3 billion compared with the average for November and December 2020 to an average of €7.5 billion, but was still at a low level. The unsecured euro short term rate (€STR) generally stood between -0.56% and -0.57% at the beginning of 2021 and was thus also somewhat lower than in November and December 2020. With the exception of the period between Christmas and New Year, €STR turnover was broadly stable and averaged €46 billion in January 2021.

Outstanding liquidity broken down by open market operation 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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rate tender procedures with full allotment at the prevailing conditions for as long as necessary.

Extension of collateral measures and swap and repo lines

Furthermore, the ECB Governing Council decided to extend to June 2022 the duration of the set of collateral easing measures adopted by the Governing Council on 7 and 22 April 2020. The extension of these measures should continue to ensure that banks can make full use of the Eurosystem's liquidity operations, most notably the recalibrated TLTROs. The Governing Council will reassess the collateral easing measures before June 2022. Lastly, the Governing Council extended the Eurosystem repo facility for central banks (EUREP) and all temporary swap and repo lines with non-euro area central banks until March 2022.

Monetary policy measures aim to preserve favourable financing conditions

The package of monetary policy measures adopted at the December meeting are intended to contribute to preserving favourable financing conditions over the pandemic period, thereby supporting the flow of credit to all sectors of the economy, underpinning economic activity and safeguarding medium-term price stability.

APP and PEPP securities holdings recorded on balance sheet see further increase

APP holdings recorded on the balance sheet rose by €67.3 billion during the reporting period. On 12 February, the Eurosystem as a whole held assets totalling €2,940.0 billion as part of the APP (see the box on pp. 24 ff. for a breakdown of the holdings by individual programme). The holdings are furthermore being influenced by the smoothing over time of reinvestments in line with the technical parameters agreed upon in December 2018 and by the use of amortised cost accounting.[2] Securities holdings reported under the PEPP amounted to €837.4 billion on 12 February, up by €195.8 billion.

2 In particular, the difference between the acquisition and redemption value is amortised over the security's residual maturity, treated as part of interest income and measured at amortised cost.

Sixth TLTRO-III sees banks take up €50.4 billion

The sixth operation of the TLTRO-III series was settled on 16 December 2020, with 156 banks taking up a total of €50.4 billion. This means that €1,749 billion is currently outstanding across all TLTRO-III operations. Banks were unable to take into account the further recalibrated conditions of the TLTRO-III in that particular operation because the deadline for counterparties to submit bids expired before the ECB Governing Council's decision. Demand for PELTROs in November and December remained very low, with a combined total of €2.6 billion, and €26.6 billion is currently outstanding on all the PELTROs settled to date.

Continued trend increase in excess liquidity

The trend increase in excess liquidity continued, particularly on the back of the Eurosystem's ongoing net asset purchases. As this report went to press, the volume of excess liquidity stood at €3,575.5 billion, which corresponds to an increase of around €267.5 billion (see the box on pp. 24 ff.).

Short-term money market rates down slightly

In the context of the ongoing increase in liquidity, short-term money market rates continued their decline overall. The unsecured euro overnight index average rate (EONIA), which is computed by applying a fixed spread to the euro short-term rate (€STR), fell by 1 basis point to -0.48% at last count, while the three-month euro interbank offered rate (EURIBOR) dropped more steeply in January to a new all-time low of -0.56%, leaving it only marginally higher than €STR. But by the time this report went to press, the three-month EURIBOR had climbed back to -0.54%, halting, for a time, the sharp downward trend that had persisted since May 2020. The yield spread between the three-month EURIBOR and three-month EONIA swap rate, which had once been used as an indicator for money market risk, remained negative.

Money market forward rates markedly higher

Money market forward rates have risen markedly since the monetary policy meeting in December 2020, probably because market participants' medium-term economic outlook has brightened and expectations of interest rate cuts receded further following the ECB Governing Council's decisions in December. At the current end, the forward curve is now only slightly inverted in the short to medium-term maturity segments. The curve bottoms out at -0.52% in the second quarter of 2022, which is presently just a few basis points below the current EONIA level. This means that only a low probability of a reduction in the Eurosystem deposit facility rate is currently priced into forward rates for all maturity segments. A very large majority of respondents to surveys conducted ahead of the Governing Council's monetary policy meetings in December and January are likewise not expecting to see any further interest rate cuts.

Monetary developments in the euro area

Monetary dynamics still very fast-paced due to coronavirus pandemic

The final quarter of the year saw monetary growth once again being shaped by the impact of the coronavirus pandemic and the economic policy response. Annual growth in the broad monetary aggregate M3 climbed to 12.3% by end-December, taking it to more than double its rate at the close of last year. Given the persistently high level of uncertainty about how the pandemic will unfold, precautionary considerations still dominated for households and enterprises, with highly liquid overnight deposits, in particular, recording substantial net growth. On the counterparts side, this development was driven notably by three factors: first, the Eurosystem's ongoing asset purchases again shored up monetary growth; second, commercial banks significantly stepped up their securitised lending to private issuers; and third, loans to the domestic private sector registered robust inflows overall, even though non-financial corporations showed less demand for loans than in the previous quarter. The banks surveyed in the Bank Lending Survey (BLS) also reported a decline in demand for loans to enterprises. At the same time, however, they also reported tightening their credit standards in all the loan categories surveyed, in particular due to higher risks caused by the pandemic.

Monetary inflows again mainly driven by overnight deposits

Among the components of M3, overnight deposits once again made by far the largest contribution to monetary growth. As in the previous quarters, additional inflows into this type of deposit came mainly from households and to a lesser extent from non-financial corporations as well. Precautionary considerations are again likely to have had a major bearing on this. Another factor behind this strong preference for liquidity, however, will have been the persistently low interest rate level and the associated low opportunity cost of holding highly liquid instruments, especially in relation to other forms of deposit. Unlike in the previous quarters, though, the fourth quarter also saw general government (excluding central government) considerably expand their overnight deposits. In their executive capacity as bodies paying government assistance, they appear to have received fairly substantial inflows of funds from central government whose deposits do not count towards M3.

Lending to domestic non-banks significantly expanded

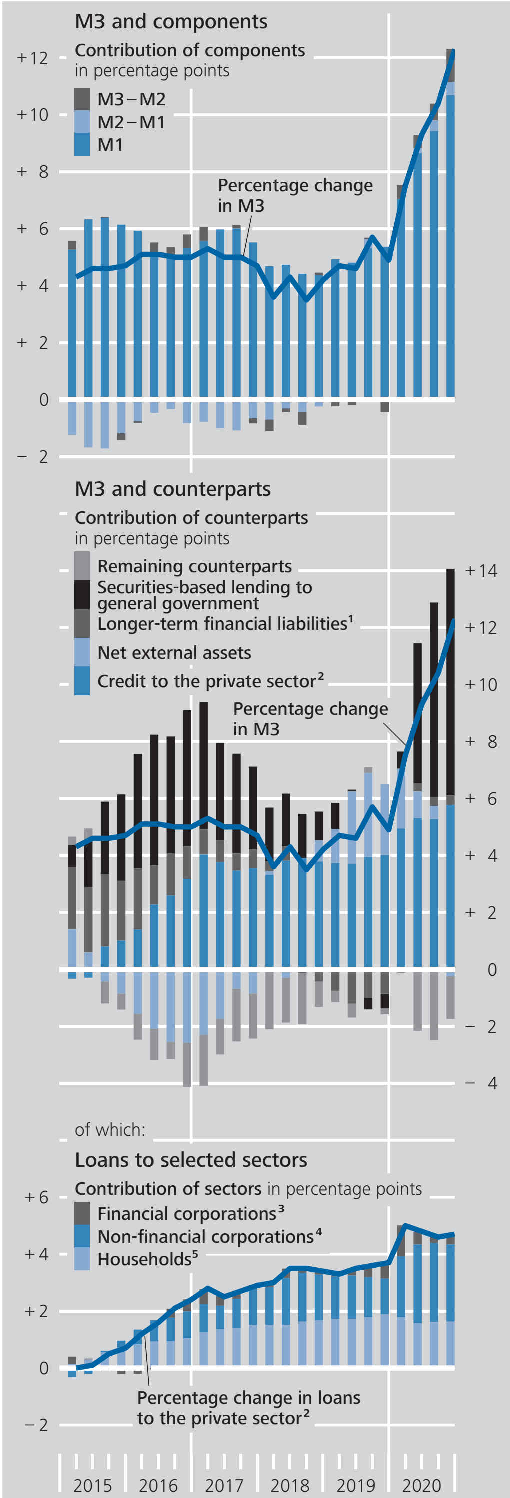
Unlike the tiers of government below the central government level, euro area central governments significantly reduced their deposit holdings in the fourth quarter. Since this liability item does not count towards M3, but rather its counterparts, its decline, when viewed in isolation, supported monetary growth (see the table on p. 30). The drop in central governments' deposits probably has something to do with the payment of assistance to the private sector against the backdrop of the tight restrictions imposed by many euro area countries in response to the pandemic. Central governments were able to draw on funds they had accumulated during the year through increased borrowing. In addition to this (pandemic-related) one-off factor, MFI lending to domestic non-banks was another major factor fuelling monetary growth once again in the fourth quarter.

Expansion of securitised lending, particularly in the form of government bonds and shares

The largest contribution to domestic lending came once again from securities-based lending to general government, even though it faded in importance relative to lending to the private sector. Compared with the exceptionally high

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 and quasi-corporations. **4** Non-financial corporations and quasi-corporations. **5** Including non-profit institutions serving households.

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

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

Assets	Q3 2020	Q4 2020	Liabilities	Q3 2020	Q4 2020
Credit to private non-MFIs in the euro area	136.1	189.1	Holdings against central government[2]	69.2	– 57.0
of which:			Monetary aggregate M3	348.4	377.3
Loans[1]	86.8	117.1	of which components:		
Securities	49.2	72.0	Currency in circulation and overnight deposits (M1)	296.7	321.6
Credit to general government in the euro area	258.8	179.3	Other short-term deposits (M2-M1)	28.6	– 8.8
of which:			Marketable instruments (M3-M2)	23.0	64.4
Loans	– 2.8	– 1.4			
Securities	261.6	180.7	Longer-term financial liabilities	5.2	– 0.6
			of which:		
Net external assets	29.9	– 95.7	Capital and reserves	8.8	47.4
Other counterparts of M3	– 2.0	47.0	Other longer-term financial liabilities	– 3.7	– 48.0

* Adjusted for statistical changes and revaluations. **1** Loans to the private non-financial sector are 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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levels seen in the previous two quarters, however, net inflows in this credit segment were markedly lower for two reasons. First, commercial banks noticeably reduced their net holdings of government bonds. Second, monthly net purchases by the Eurosystem were also down slightly on the quarter.

A much smaller contribution to M3 growth, though one that was larger than it had been one quarter earlier, came from securitised lending to the domestic private sector, with the MFI sector purchasing both shares and investment fund shares as well as bonds and debt securities. One factor spurring banks' increased demand for equities will have been the general uptick in sentiment on news that the first coronavirus vaccines had been approved.

Loans to households continue pre-COVID-19 upward trend

Loans to households recorded strong net inflows in the fourth quarter in a continuation of the upward trend they have been charting since 2014 and which was interrupted in the first half of 2020 as action was taken to contain the pandemic. The most significant contributions were made by banks in Germany and France, which had also recorded the strongest growth prior to the outbreak of the pandemic. Growth was again driven primarily by loans for house purchase, the interest rates for which hit new historical lows. At the end of the fourth quarter, their annual growth rate increased to 4.7%, the highest rate seen since 2008. Other lending, which mainly comprises loans to self-employed persons, recorded further growth. Consumer credit, meanwhile, saw interest rates remain largely unchanged and receded slightly in the fourth quarter, which probably had something to do with the tighter containment measures introduced in response to coronavirus, giving households less of an opportunity to spend. However, the decline in this market segment was significantly weaker than it had been in the first phase of pandemic-related restrictions in the second quarter of 2020.

Banks report brisker demand for housing loans among households, …

According to the bank managers surveyed as part of the BLS, household demand for loans for house purchase in the euro area increased again in the fourth quarter, exceeding the expectations they had reported in the previous quarter. They reported that credit demand had particularly been stimulated by the low general level of interest rates. The coronavirus pandemic, when viewed in isolation, had both positive and negative effects on demand. In some countries, banks reported that catch-up effects impacted positively on demand. However, the bank managers surveyed as part of the BLS also pointed to the downside of the coronavirus pandemic, such as the difficulties it presented for property viewings and notary visits. Asked to report on consumer credit and other lending to households, the banks surveyed in the BLS said that credit demand had declined in the fourth quarter because of a lack of consumer confidence and dwindling spending on durable consumer goods.

… while credit standards were tightened at the same time

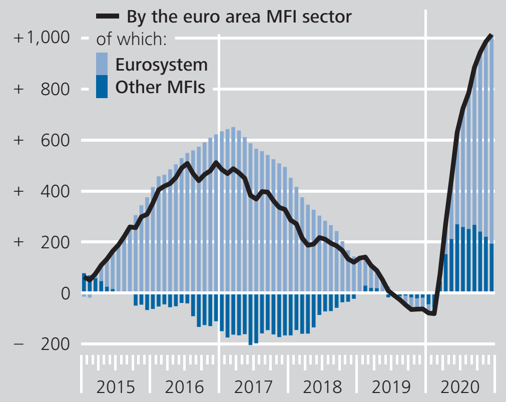
On the supply side, the banks that responded to the survey tightened their standards for housing loans once again. However, standards were tightened to a much lesser extent than they had been in the preceding two quarters. One reason for the current tightening of standards was the banks' deteriorated assessment of the general economic situation and outlook. Borrowers' creditworthiness was also assessed somewhat less positively in the fourth quarter. In addition, lower risk tolerance again led standards to be made more restrictive. By contrast, for the first time in a year, the banks surveyed by the BLS responded somewhat more optimistically again when assessing the outlook on the residential real estate market and the prospective development of prices for residential real estate. On balance, banks in the euro area also tightened their conditions for consumer credit and other lending marginally again in the fourth quarter of 2020 after having tightened them considerably in some cases in the preceding three quarters. The rejection rate rose only slightly after having increased sharply in the previous three quarters. For this reason, it is currently likely to persist at an elevated level.

Loans to non-financial corporations continue to grow at a decelerated pace

In contrast to the upward trend in loans for house purchase, the growth in loans to non-financial corporations continued to decelerate in the fourth quarter. In this context, there was a continued tendency to redeem short-term loans in net terms in favour of building up longer-term loans, albeit at a somewhat slower pace. Overall, despite the persistently very low interest rate level, net inflows fell short of the quarterly figures during the last two years before the pandemic. A key reason for the relatively weak demand for credit among non-financial corporations in the fourth quarter was

Securities-based lending to general government in the euro area

€ billion, 12-month accumulated flows



Sources: ECB and Bundesbank calculations.
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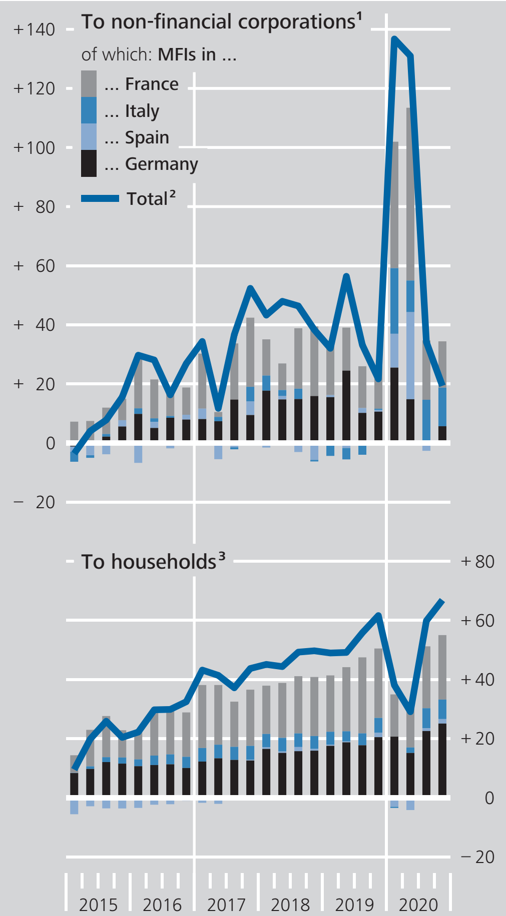
that, on the whole, this sector had built up extraordinarily large liquidity reserves since the beginning of the coronavirus pandemic. As described above, non-financial corporations recently continued to top up their stock of short-term bank deposits. In conjunction with the fact that economic activity in the euro area declined less sharply at the end of the year than it had in the first phase of the pandemic, this suggests that enterprises' need for additional funding was, on balance, low. However, the weaker overall demand for credit was attributable to seemingly large differences in the liquidity situations of individual enterprises and sectors resulting from the differing extents to which they were impacted by the pandemic.

BLS banks reported decline in credit demand amongst enterprises …

The bank managers interviewed as part of the BLS likewise reported that demand for loans among non-financial corporations had fallen slightly again in the fourth quarter. As in the preceding quarter, respondents mainly put the decreased need for funding down to enterprises' reluctance to engage in fixed investment, mergers, takeovers, and restructuring as a result of the pandemic. By contrast, they reported that enterprises' funding requirements for inventories and working capital as well as for refinancing, debt restructuring and renegotiation had risen once again.

MFI loans to the non-financial private sector in the euro area*

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



Sources: ECB and Bundesbank calculations. * Adjusted for loan sales and securitisation. 1 Non-financial corporations and quasi-corporations. 2 Also adjusted for positions arising from notional cash pooling services provided by MFIs. 3 Including non-profit institutions serving households.
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… and tightened lending standards

At the same time, the surveyed banks stated that, on balance, they had continued to tighten their corporate credit standards in the fourth quarter. According to the banks, this was again primarily attributable to their deteriorated risk assessments. First, the euro area banks justified their tightening of standards on the basis of the darker current economic situation and general economic outlook. Second, in comparison to the preceding quarter, they took a bleaker view of both the situations of individual sectors and enterprises as well as the creditworthiness of borrowers. Alongside this, the banks' lower risk tolerance and a decline in the underlying value of collateral contributed to the tightening of standards. The banks' improved liquidity position per se led to a slight easing of standards. At the same time as tightening their credit standards, the surveyed banks also tightened their credit terms and conditions in the fourth quarter, particularly for small and medium-sized enterprises. The heightened risk sensitivity among respondents was reflected above all in higher requirements for loan collateral, but also in wider margins for riskier loans as well as stricter covenants.

Net capital exports dampened monetary growth

Only the net external position of the MFI sector had a noticeably dampening impact on monetary growth in the fourth quarter of 2020. According to the non-seasonally adjusted balance of payments data, which are currently only available for October and November, the strong outflows of funds were the result of opposing effects. On the one side, the considerable net capital exports in the balance of cross-border securities transactions was a major factor. As in previous quarters, residents purchased larger volumes of foreign securities, especially shares and investment fund shares. What is more, unlike in previous quarters, non-residents also sold off securities issued by domestic non-banks in net terms – primarily government bonds – against the background of the strong euro. On the other side, the current account surplus, which had grown further, exerted a positive influence on the net external position. The supporting factors, which also included the rise in the balance of direct investment in the fourth quarter, were nevertheless unable to offset the strong dampening impact of securities transactions.

German banks' deposit and lending business with domestic customers

Deposit growth still dominated by build-up of overnight deposits

In the final quarter of 2020, German banks' deposit business with domestic customers was also characterised by an exceptionally strong preference for liquidity among domestic investors. In this context, banks' customers once again significantly increased their holdings of overnight deposits from October to December. At the same time, they continued to scale back their holdings of less flexible time and savings deposits – in some cases at a significantly quicker pace – for both short-term and longer-term maturities. The yields that these types of deposit offer over overnight deposits are still at a record low level (see the adjacent chart).

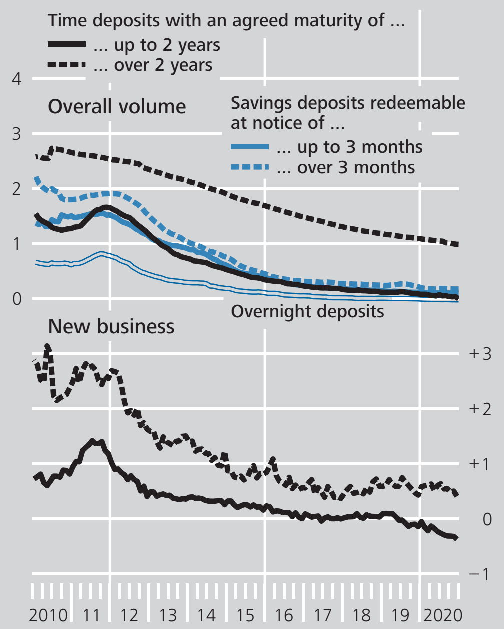
Little change in investment behaviour in individual sectors

Sectoral developments in the fourth quarter showed only little change against the preceding quarters. Households in particular strongly increased their holdings of overnight deposits again. One likely reason for this, besides the interest rate levels, is the pandemic-related restrictions to travel and the renewed business closures. These meant that a large portion of the consumption expenditure otherwise usually seen in the fourth quarter failed to materialise.

In addition, non-financial corporations also markedly topped up their overnight deposits once again, even though net growth in this sector was weaker than in previous quarters. At the same time, and unlike in previous quarters, non-financial corporations' short-term time deposits remunerating at close-to-market rates registered heavy outflows, which left the increase in non-financial corporations' holdings of deposits well down on the level seen in previous quarters overall. Any assessment of this development needs to bear two factors in mind. First, interest rates on overnight and time deposits have fallen deeper into negative territory (for more information, see the box on pp. 34 f.). Second, the comparatively weak build-up of deposits in this sector is also likely to be related to the reimposition of significantly tighter restrictions to contain the pandemic: for the enterprises directly affected, this meant considerable losses of sales and income. Consequently, it is to be assumed that these enterprises had to make greater use of existing liquidity buffers or take out loans to cover their current expenditure, while other enterprises hit less strongly by the pandemic continued to receive inflows of funds.

Interest rates on bank deposits in Germany*

% p.a., monthly data



* Deposits of households and non-financial corporations according to the harmonised MFI interest rate statistics (volume-weighted interest rates). Interest rate levels for overnight and savings deposits may also be interpreted as new business due to potential daily changes in interest rates.
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Lending business with non-banks regains momentum

Compared with the previous quarter, banks' lending business with the domestic non-bank sector regained momentum in the fourth quarter of 2020. This was because lending to the domestic private sector picked up considerably again in the reporting quarter. By contrast, banks in Germany markedly reduced their lending to the public sector – as they had in the previous quarter – both in terms of loans and securities in an ongoing reversal of the noticeable uptick in lending to general government in the first half of the year.

Household demand for housing loans still brisk

In the fourth quarter of 2020, the largest net growth in loans to the private sector was again recorded by households. Demand here was fuelled primarily by persistently brisk demand for housing loans, which gained fresh momentum alongside the exceptionally robust activity in the construction sector. On balance, the growth rate of loans taken out for house purchase rose further to 6.5% on the year, representing its highest value since 2000.

Negative interest rates on the deposits of non-financial corporations and households in Germany

The proportion of banks in Germany charging, on average, negative interest rates on customer deposits continued to grow in 2020. Regarding overnight deposits and time deposits of non-financial corporations, the aggregate interest rate calculated in the MFI interest rate statistics[1] has likewise been negative since 2016. By contrast, the interest rate on the time deposits of households remained positive on average. The aggregate interest rate on households' overnight deposits is marginally above zero.

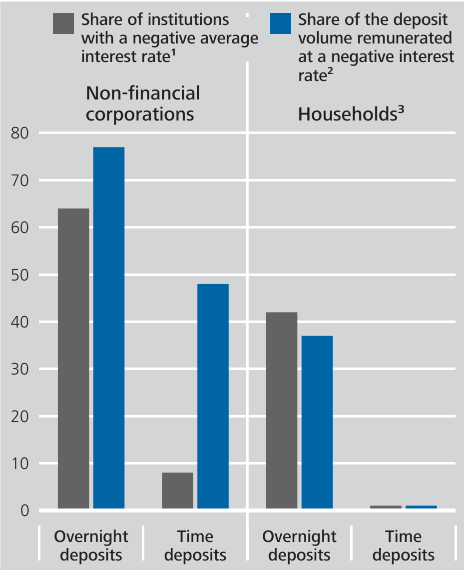
The MFI interest rate statistics calculate the level of interest rates applied to non-financial corporations and households (as well as the corresponding volumes) on a monthly basis. The collected data are designed to provide a representative sample, with each of the 212 banks currently in the sample reporting its volume-weighted average interest rates for the individual deposit items to the Bundesbank. Since the average figures are calculated by the reporting bank, these data provide no basis for determining how many banks in Germany have introduced negative deposit rates. Furthermore, the interest rate statistics give no insight into the actual proportion of deposits remunerated at negative rates in Germany. The data from the interest rate statistics do, however, serve as a tool for extrapolating the share of the volume of deposits held by institutions charging, on average, a negative interest rate in the total volume of deposits held by German banks. Because the sample is representative in nature, such extrapolation allows qualified conclusions to be drawn about the distribution, in relative terms, of negative interest rates across customer deposits within the German banking sector.

In December 2020, 64% of reporting institutions reported a negative volume-weighted average interest rate on overnight deposits held by enterprises. The sum of all deposits (at both positive and negative interest rates) held at these institutions corresponds to 77% of the total volume of overnight deposits of enterprises held at German banks. In this context, the policy of charging enterprises negative interest rates is no longer limited to certain banking groups, but now appears to have become standard practice.

In the case of households' overnight deposits, the share of German institutions reporting a negative volume-weighted average interest rate stood at 42% in December 2020, representing a significant rise on the previous year. The volume of deposits (at both positive and negative interest rates) at these institutions corresponds to 37% of the total volume of households' overnight deposits at German banks, with negative interest rates being levied mainly by savings banks and cooperative banks, and to a lesser extent by big banks and regional banks. Any account management fees that might be charged in addition or as an alternative to negative interest rates are

Bank deposits remunerated at a negative interest rate in Germany

%, month-end data: December 2020



1 Share of reporting institutions with a volume-weighted negative average interest rate in the full MFI interest rate statistics sample comprising 212 institutions. **2** Share of the extrapolated deposit volume of institutions with a negative average interest rate in the total deposit volume of banks in Germany. **3** Including non-profit institutions serving households.

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1 See Deutsche Bundesbank (2017). For the purpose of analysing time deposits, the aforementioned statistics rely on rates and volumes recorded under new deposits activity. In the case of overnight deposits, the focus lies on interest rate levels, which, however, may also be interpreted as new business due to potential daily changes in interest rates.

not encompassed in the MFI interest rate statistics.

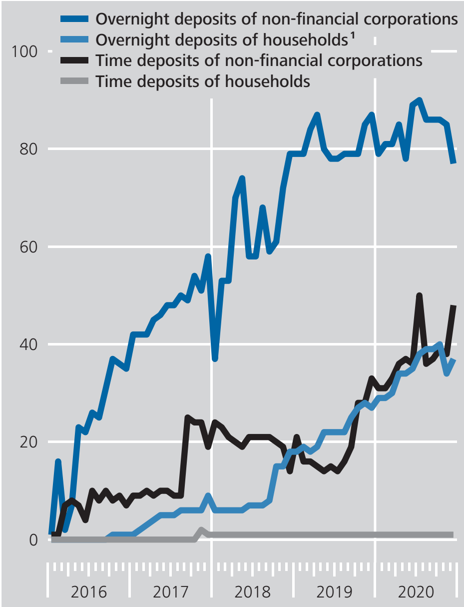
With regard to time deposits, the practice of charging negative interest is less widespread. In December 2020, only around 8% of institutions reported negative average interest rates on time deposits for enterprises, and around 1% of institutions reported negative average interest rates on time deposits for households. These results represent volume shares of 48% and 1% respectively.

Since 2015, there has been a steady increase in the share of the deposit volume of institutions with a negative average interest rate in the total deposit volume of banks. At first, this development only applied to enterprises' overnight deposits. The average remuneration posted at the institution level for these deposits is now negative at the vast majority of banks. According to the reporting institutions, large-scale deposits are the main reason for negative volume-weighted average rates at this level. Negative interest has been levied on enterprises' time deposits to a notable extent since 2016. In this context, the proportion of deposits subject to negative interest went up by 15 percentage points in 2020. A similar, hitherto uninterrupted, upward trend affecting households' overnight deposits has also been observed: since 2016, the extrapolated deposit volume of institutions with a negative average interest rate as a share of the total deposit volume has risen by just under 10 percentage points each year. By contrast, negative interest rates have thus far remained the exception, rather than the rule, in the case of households' time deposits.

Empirical studies on interest rate pass-through show that, in Germany, interest rates on customers' deposits usually reflect developments in short-term market interest rates, albeit at a more elevated level, at least in aggregate terms.[2] The relationship between deposit rates and market interest rates evident prior to the onset of the negative interest rate environment has not changed to any significant degree in the past few years. Viewed in the long term, it remains the case that just over 70% of any changes in the twelve-month EURIBOR rate are passed through to the interest rate on time deposits held by households and non-financial corporations.[3] Overnight deposits have a long-term relationship with EONIA: 56% of any changes in this market rate are passed through to non-financial corporations' overnight deposits over the long term, and just under half of these changes are passed through to households' time deposits.[4] Given the level of market rates, the current level of aggregate deposit rates is neither surprisingly high nor unexpectedly low.

Bank deposits remunerated at a negative interest rate in Germany*

%, month-end data



* Share of the extrapolated deposit volume of institutions with a negative average interest rate in the total deposit volume of banks in Germany. **1** Including non-profit institutions serving households.

Deutsche Bundesbank

2 The twelve-month EURIBOR has lingered in negative territory since February 2016, dipping to -0.5% at the end of December 2020. EONIA has been negative since November 2014, sliding to -0.47% at the end of December 2020.
3 The interest rate on households' time deposits has, on average, hovered 41 basis points above the twelve-month EURIBOR rate since 2003. Meanwhile, the spread for time deposits held by non-financial corporations has stood at around 7 basis points (model constants within the framework of a single-equation error-correction model).
4 The interest rate charged, on average, on the overnight deposits of non-financial corporations has stood at around 14 basis points above the EONIA rate since 2003, compared with 20 basis points for households' overnight deposits.

MFI* lending and deposits in Germany

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

Item	2020 Q3	2020 Q4
Deposits of domestic non-MFIs[1]		
Overnight	63.9	54.0
With an agreed maturity of		
up to 2 years	− 5.0	− 20.9
over 2 years	− 9.9	− 5.9
Redeemable at notice of		
up to 3 months	− 0.3	− 0.9
over 3 months	− 1.4	− 0.9
Lending		
to domestic general government		
Loans	− 1.7	− 2.9
Securities	− 5.1	− 9.1
to domestic enterprises and households		
Loans[2]	21.7	34.0
of which: to households[3]	22.3	24.7
to non-financial corporations[4]	− 0.6	5.8
Securities	2.3	0.2

* As well as banks (including building and loan associations, but excluding the Bundesbank), monetary financial institutions (MFIs) here also include money market funds. 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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The lively demand for housing loans was buoyed by what remained extraordinarily favourable funding costs: the MFI interest rate statistics indicate that the interest rate for housing loans fell again slightly in the fourth quarter to a new record low. Alongside this, the labour market situation, which stayed largely stable despite the stricter measures to contain the pandemic, and households' income and asset situation, which likewise remained solid, are likely to have supported their demand for housing loans. The BLS results suggest that other factors were at play as well: the banks surveyed by the BLS reported that the low general level of interest rates as well as the good outlook for both the residential real estate market and real estate prices were key factors driving the uptick in demand. Refinancing, restructuring and renegotiation also had a positive influence on demand.

Standards for housing loans unchanged, credit terms and conditions tightened once again

In the fourth quarter of 2020, credit standards for private housing loans remained unchanged on balance. This means that, since the outbreak of the pandemic, the banks surveyed by the BLS only significantly tightened their standards in this lending segment in the second quarter of 2020. By contrast, the tightening of credit terms and conditions that began in the second quarter of 2019 also continued in the final quarter of 2020. In this context, the surveyed banks widened their margins for riskier loans by somewhat more than for loans with average risk levels. Bank managers stated their lower risk tolerance and the somewhat lower degree of competition as their reasons for widening margins. Furthermore, the cost of funds and balance sheet constraints also contributed to the widening of margins.

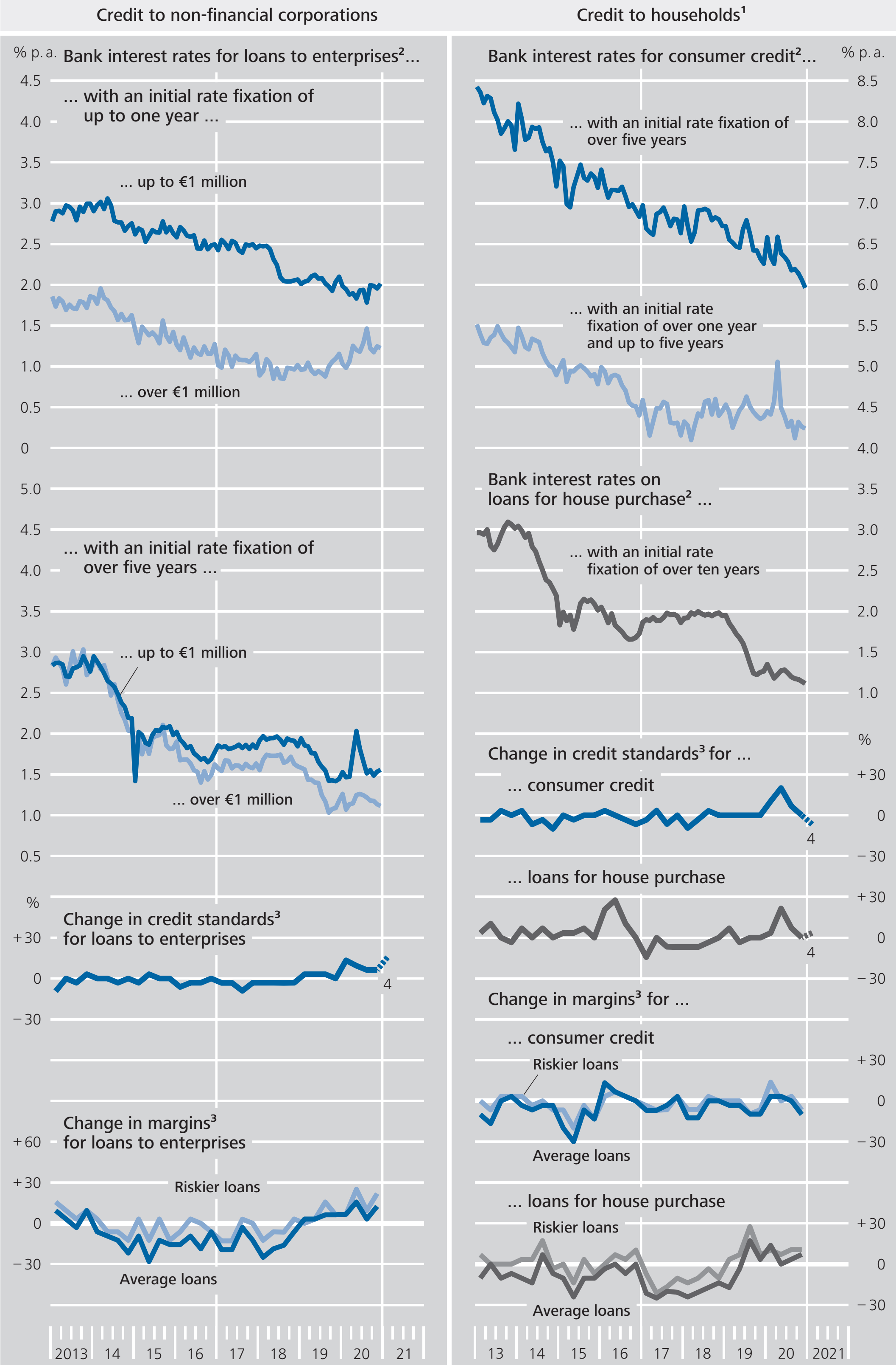
Consumer credit business negative due to pandemic-related reluctance to consume

In contrast to housing loans, consumer credit to households decreased in net terms in the fourth quarter, following a marked expansion in the preceding quarter. The decisive factor for this was the reluctance to consume arising from the second wave of the coronavirus pandemic and the measures taken to contain it: due to the pandemic-related travel restrictions and business closures, many of the opportunities for consumption that would otherwise be typical of this time of year were either partially or entirely unavailable. In addition, according to the assessments of the banks surveyed by the BLS, demand for credit was dampened by the lower consumer confidence that resulted from the uncertainty surrounding the economic fallout from the pandemic. Despite this, the BLS banks reported that demand for consumer credit (and other lending) remained largely stable over the reporting quarter. Both the standards as well as the terms and conditions for consumer credit and other lending were left unchanged overall by the surveyed banks during the fourth quarter of 2020.

Lending business with non-financial corporations noticeably positive …

In the final quarter of the year, loan business with domestic non-financial corporations increased markedly on balance, after having declined slightly in the previous quarter. Net growth was recorded solely for maturities longer than five years, which bounced back

Banking conditions in Germany



1 Including non-profit institutions serving households. **2** New business. According to the harmonised MFI interest rate statistics. **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 Q1 2021.

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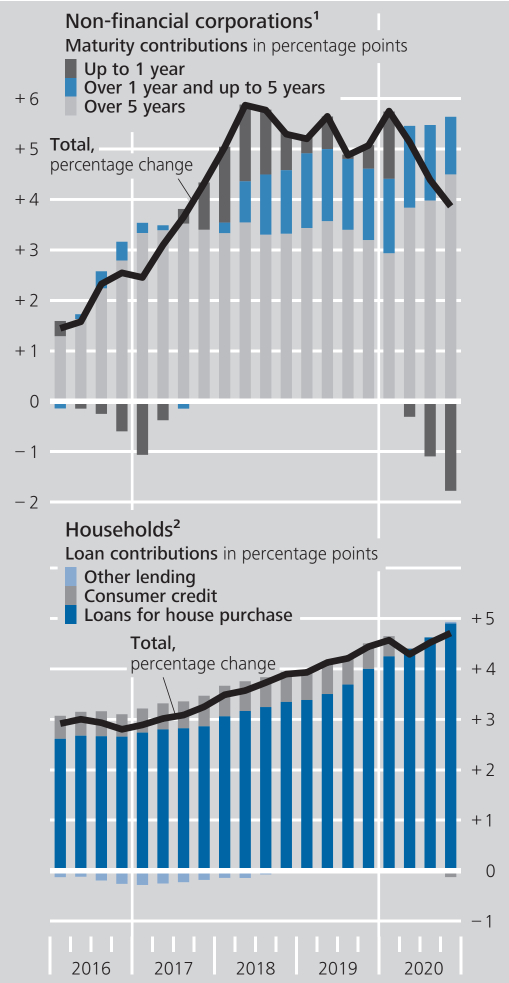
Loans* by German banks to the domestic non-financial private sector

Year-on-year change, 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

more strongly following a slowdown in the summer months. By contrast, short-term loans to non-financial corporations declined in net terms for the third consecutive quarter.

… on the back of strong demand for funds to cover current expenditure …

The most recent results of the BLS give some indication of the reasons for the increase in overall demand for loans among non-financial corporations: according to bank managers' responses, the uptick was caused primarily by the greater funding needs for refinancing, debt restructuring and renegotiation as well as the high financing needs for inventories and working capital. The surveyed banks again identified enterprises' reluctance to engage in fixed investment, which had already been observed in the preceding quarters, as a factor that dampened demand.

… and individual sectors still proving to be robust

Nevertheless, the heightened uncertainty regarding future economic developments as well as the resulting reluctance to invest did not affect all economic sectors to the same degree. The borrowers statistics show that some sectors of the economy that are not directly impacted by the coronavirus-related restrictions – the construction and real estate sector in particular – continue to require high amounts of funding.

Lending policies more restrictive overall

BLS data furthermore suggest that banks in Germany again made their lending policies more restrictive for corporate customers in the fourth quarter in response to the economic fallout from the coronavirus pandemic. Credit standards for corporate financing were tightened again on balance in the fourth quarter of 2020, with standards being tightened to a similar extent across all maturities and enterprise sizes. As justification for making their standards more restrictive, the surveyed bank managers stated the depressed general economic situation and the deteriorated economic outlook resulting from the pandemic. However, a similarly important role was also played by their more pessimistic assessments of both the situations of individual sectors and enterprises as well as of borrowers' creditworthiness in response to the pandemic. The proportion of rejected loan applications grew somewhat over the previous quarter during the reporting period. Following the rises observed in the second and third quarters, the rejection rate is thus holding steady at an elevated level. In particular, enterprises in sectors that are especially hard hit by the crisis – such as hotel and restaurant services and retail trade – had more limited access to credit than those in sectors that were less strongly impacted by the economic fallout from the pandemic.

The surveyed banks also tightened their credit terms and conditions overall, mainly due to the fact that they considered credit risk to have risen as a result of the pandemic. This was reflected, first, in a widening of margins for riskier loans in particular. Second, credit institutions tightened their collateral requirements for the fourth time in succession.

Impact of NPL ratio on German banks' lending policy marginally restrictive in second half of 2020

In response to the ad hoc questions asked in the January BLS, German banks reported that their funding situations had improved again on the quarter, especially with regard to raising funding through bank debt securities and on the unsecured money market. Banks responded to new regulatory and supervisory activities by continuing to strengthen their capital position last year. These activities largely had no impact on credit standards during the same period, though they did have a restrictive effect on the margins in corporate lending. According to banks, the share of non-performing loans in the gross book value of loans – i.e. the NPL ratio – contributed only marginally to a tightening of their lending policies in the second half of 2020. In the first half of 2021, however, banks are anticipating an increase in its restrictive impact, especially with regard to lending to enterprises.

Demand among firms for government-guaranteed coronavirus assistance loans mainly to cover acute liquidity needs and build up liquidity buffers

In contrast to the standards for loans without government guarantees, standards for coronavirus assistance loans fully or partially guaranteed by government were eased in 2020. According to the banks' responses, enterprises mainly showed an interest in coronavirus assistance loans to cover their acute liquidity needs or to build up liquidity buffers as a precautionary measure.

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