Monetary policy and banking business

Monetary policy and money market developments

ECB Governing Council adjusts forward guidance on policy rates …

At its March meeting, the ECB Governing Council made a number of new monetary policy decisions. First, the Council adjusted the calendar-based element of its guidance on future key policy rate developments ("forward guidance"). The ECB Governing Council now expects policy rates to remain unchanged at least through the end of 2019. The state-contingent element of the Council's forward guidance indicates, moreover, that policy rates will, in any case, remain at their present levels for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term. The ECB Governing Council did not change its forward guidance regarding the reinvestment of securities acquired as part of the expanded asset purchase programme (APP). Policy rates were also left unadjusted in the period under review. The main refinancing rate thus remains at 0%, while the rate of the marginal lending facility stands at 0.25% and the deposit facility rate at -0.40%.

… and approves new series of TLTROs

Second, the ECB Governing Council decided to launch a new series of targeted longer-term refinancing operations (TLTRO-III). They are intended to help to preserve favourable bank lending conditions and the smooth transmission of monetary policy. The ECB Governing Council communicated that these new operations will be conducted at quarterly intervals from September 2019 to March 2021 and will each have a maturity of two years. Under these operations, banks will be entitled to borrow funds totalling up to 30% of the stock of eligible loans as at 28 February 2019. Over the maturity of each individual operation, the interest rate will be indexed to the interest rate on the main refinancing operations. Like the previous series of TLTROs, TLTRO-III will also include incentives to lend. The ECB Governing Council will announce further details on the precise terms of TLTRO-III at one of its upcoming meetings. This will also include establishing the interest rate conditions. In particular, this decision will take into account a thorough assessment of the bank-based transmission channel of monetary policy as well as further developments in the economic outlook.

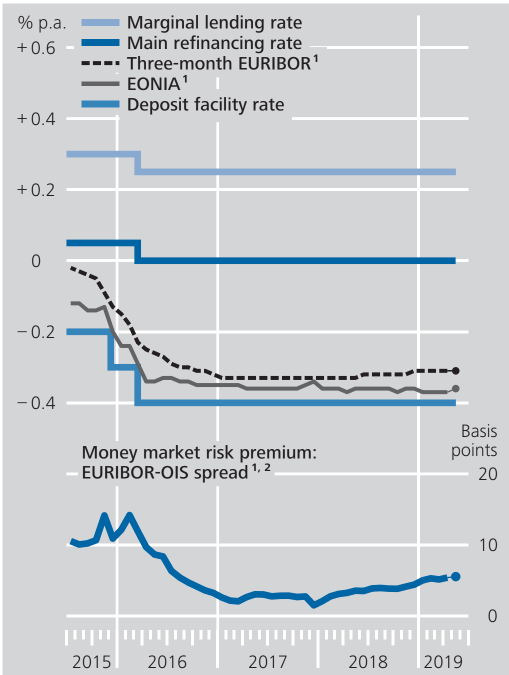
ECB Governing Council extends full allotment policy to 2021

Furthermore, the ECB Governing Council decided at its March meeting to conduct all of its refinancing operations as fixed rate tender procedures with full allotment for as long as necessary, and at least until the end of the reserve maintenance period starting in March 2021.

ECB Governing Council announces review of impact of negative interest rates

Following its April meeting, the ECB Governing Council indicated that its regular assessment will consider whether any side effects on bank intermediation might necessitate mitigating

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 16 May 2019.

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Money market management and liquidity needs

The two reserve periods between 30 January 2019 and 16 April 2019 saw a slight decrease in euro area liquidity needs stemming from autonomous factors (see the table below). At an average of €1,363.3 billion in the March-April 2019 period, they stood €49.2 billion below the average for December 2018-January 2019, the period preceding the periods under review. The sum of the autonomous factors fluctuated within a corridor between €1,323.0 billion and €1,417.7 billion. The decrease in liquidity needs was mainly due to the liquidity-increasing rise in the combined total of net foreign assets and other factors, which are considered together as a result of liquidity-neutral valuation effects. In aggregate terms, they went up by €85.4 billion over the aforementioned timeframe. A corresponding decline of €3.0 billion in banknotes in circulation to €1,215.8 billion also reduced liquidity needs (see the chart on p. 23). The larger volume of general government deposits with the Eurosystem, on the other hand, increased the need for liquidity: in the March-April 2019 period, they stood at an average of €270.5 billion, €39.2 billion higher than the average for the December 2018-January 2019 period. The minimum reserve requirement in the March-April 2019 reserve period amounted to €128.4 billion.

The outstanding tender volume from the Eurosystem's open market operations changed only slightly during the reporting period. In the March-April 2019 reserve period, it averaged around €726 billion, putting it just short of €6 billion below the corresponding figure for the December 2018-January 2019 period. The decrease stemmed from a reduction in banks' partici-

Factors determining banks' liquidity*

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

Item	2019: 30 January to 12 March	2019: 13 March to 16 April
I Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors		
1 Banknotes in circulation (increase: –)	+ 9.6	– 6.6
2 Government deposits with the Eurosystem (increase: –)	– 26.0	– 13.2
3 Net foreign assets[1]	+ 9.7	+ 13.1
4 Other factors[1]	+ 46.8	+ 15.8
Total	+ 40.1	+ 9.1
II Monetary policy operations of the Eurosystem		
1 Open market operations		
(a) Main refinancing operations	– 1.9	– 0.3
(b) Longer-term refinancing operations	– 0.7	– 2.8
(c) Other operations	– 7.0	– 9.9
2 Standing facilities		
(a) Marginal lending facility	+ 0.0	+ 0.0
(b) Deposit facility (increase: –)	+ 2.4	+ 18.0
Total	– 7.2	+ 5.0
III Change in credit institutions' current accounts (I + II)	+ 32.7	+ 14.2
IV Change in the minimum reserve requirement (increase: –)	– 0.5	– 0.5

* 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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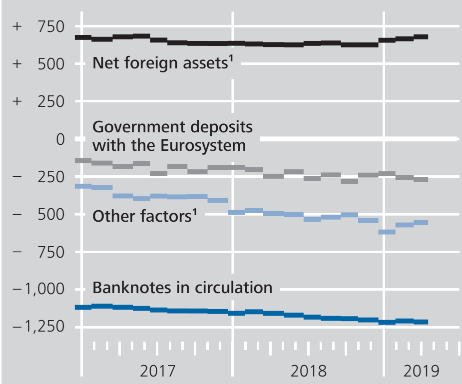
pation in the regular tender operations as well as voluntary early repayments of the second series of targeted longer-term refinancing operations (TLTRO-II), which came to €3.4 billion towards the end of March. This translates into a total of approximately €715 billion still outstanding in the four TLTRO-II operations. Demand for the main refinancing operation in the March-April 2019 period fell to an average of €5.7 billion (-€2.2 billion compared with the December 2018-January 2019 period). In addition, comparing averages for the same periods, the outstanding volume of three-month tenders decreased by €1.4 billion to €3.6 billion.

The bulk of the central bank liquidity continued to be provided by the Eurosystem through its monetary policy asset purchase programmes. They accounted for nearly four-fifths of the total liquidity made available through open market operations in the reporting period. The average balance sheet holdings of all purchase programmes in the March-April 2019 period stood at €2,636 billion, representing a decline of €17 billion compared to the corresponding average holdings during the December 2018-January 2019 reserve period. The end of the net purchases, amortisation adjustments, maturities and flexibility in terms of reinvestment played a role in this (see the adjacent table). The share of the PSPP in the holdings of all purchase programmes amounted to 71%. As a result of this reduction in the holdings of securities and the decrease in the tender volume in the period under review, central bank liquidity supplied by means of open market operations fell again slightly. The trend of a continuous increase in outstanding liquidity from open market operations, observed since the launch of the PSPP purchases in March 2015, thus reversed at the beginning of the year (see the chart on p. 25).

Autonomous factors in the Eurosystem

€ billion, mean values for the relevant reserve maintenance period



Sources: ECB and Bundesbank calculations. **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 10 May 2019
Active programmes[1]		
PSPP	− 6.8	2,092.8
CBPP3	− 0.7	261.6
CSPP	− 0.2	177.8
ABSPP	− 0.7	26.2
Completed programmes		
SMP	− 10.3	62.8
CBPP1	− 0.8	3.2
CBPP2	− 0.2	3.5

1 Changes due to maturities, reinvestments and amortisation adjustments.
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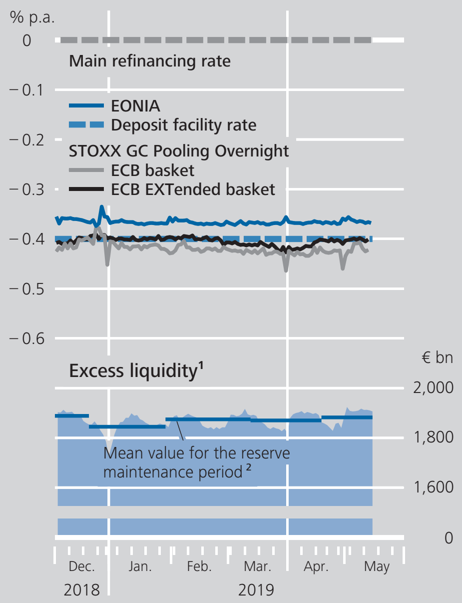
This reduced liquidity provision counteracted a stronger rise in excess liquidity, despite the somewhat lower liquidity needs stemming from autonomous factors. It reached an average value of €1,870 billion during the March-April 2019 reserve period, thus increasing by €25 billion compared to the December 2018-January 2019 period. In the intervening period, excess liquidity was only marginally higher, averaging €1,874 billion. Overall, excess liquidity in the reporting period thus remained within the ranges that had already been observed over the course of 2018. At that time, the increasing autonomous factors effectively prevented a rise in excess liquidity, in spite

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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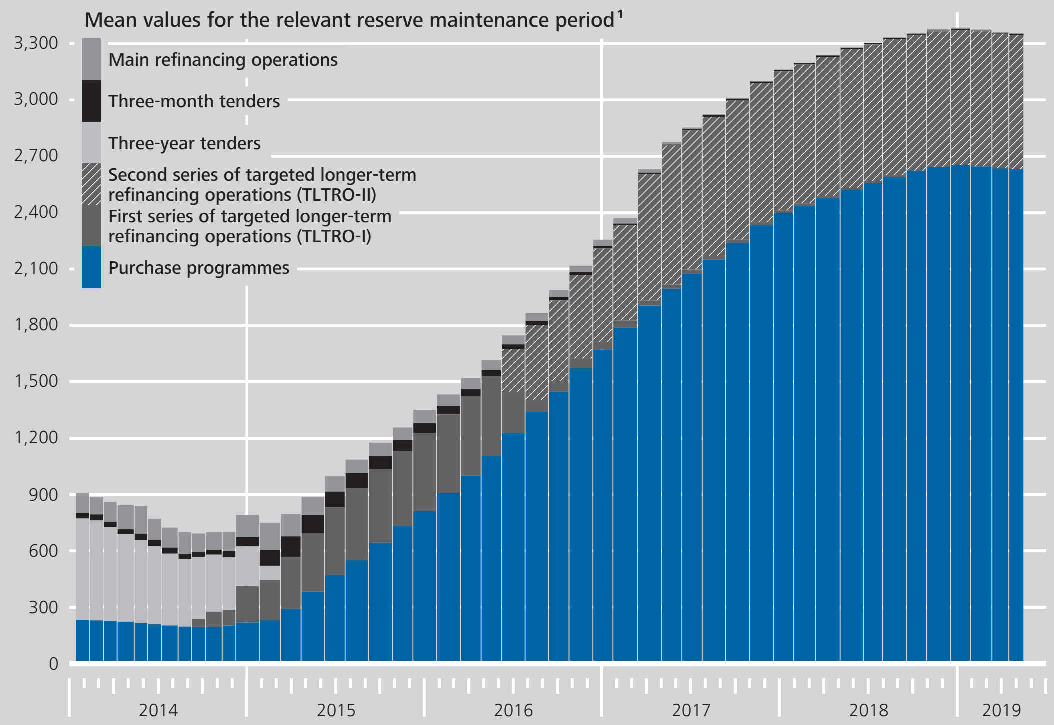
of the net purchases under the purchase programmes.

On account of the very favourable liquidity conditions, overnight rates continued to be geared to the rate on the deposit facility (see the chart above). In the March-April 2019 reserve period, EONIA once again stood at an average of -0.37%. This was already the case in the previous two reserve periods. At an average of €2.6 billion, the underlying EONIA turnover for unsecured overnight deposits remained low. Secured overnight deposits, on the other hand, mainly traded below the deposit facility rate: on the GC Pooling platform, overnight trades in the ECB basket in the March-April 2019 period were executed at an average of -0.43% and thus 1 basis point below the December 2018-January 2019 period. Overnight deposits in the ECB EXTended basket, with its larger set of eligible securities, traded at -0.42% on average in the March-April 2019 period, which was also lower than in the December 2018-January 2019 period (-0.38%). Aggregate overnight turnover across both segments in the March-April 2019 reserve period amounted to an average of €9.1 billion; as such, it exceeded the December 2018-January 2019 reference period level of €7.0 billion, and remained clearly above the EONIA turnover.

At 56 days, the particularly long current reserve period of April-June 2019 indicates a continuation of the aforementioned developments at present. As such, euro area liquidity needs stemming from autonomous factors again saw a slight decrease up to 10 May 2019 – despite a marked rise in banknotes in circulation in the wake of the Easter holidays. The growing trend in the minimum reserve requirement and the limited interest of credit institutions in the Eurosystem's standard tenders are also continuing. Overnight rates barely changed in the first three full weeks of the current reserve period.

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

€ billion



Sources: ECB and Bundesbank calculations. **1** The bar width corresponds to the length of the reserve maintenance period. The last period displayed is still ongoing.
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measures in order to preserve the favourable economic implications of negative interest rates.

Adjustment of inflation slowed by weaker economic activity

The monetary policy decisions in March were taken against the backdrop of renewed weaker economic data. According to the ECB Governing Council's analysis, these data are indicative of the slowdown in economic growth that was already observed in 2018 continuing into the current year. Accordingly, the ECB staff forecasts for GDP growth in 2019 presented at the beginning of March were also considerably weaker than they had been even in December. The forecasts state that the persistence of uncertainties related to geopolitical factors, the threat of protectionism and vulnerabilities in emerging markets are leaving their mark on economic sentiment. The monetary policy decisions of March are intended to ensure that the sustained convergence of inflation to a level below, but close to, 2% over the medium term will continue despite the weaker economic data.

Positive labour market developments and higher wage growth support gradually increasing inflationary pressures

In addition, the ECB Governing Council stated that some country-specific factors that are dampening growth are starting to abate. At the same time, supportive financing conditions, favourable labour market dynamics with further growth in employment and rising wage growth continue to underpin the euro area expansion and gradually rising inflation pressures.

Little change in securities holdings recorded on balance sheet

The APP holdings recorded on the balance sheet continued to see slight fluctuations over time. This was due, on the one hand, to the smoothing over time of reinvestments as part of the technical parameters agreed upon in December and, on the other hand, to the use of amortised cost accounting.[1] On 10 May 2019,

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

the Eurosystem held assets totalling €2,558 billion as part of the APP (see the box "Money market management and liquidity needs" on pp. 22 ff. for a breakdown of the holdings into the individual programmes).

Limited repayments of TLTRO-II once again

The first quarter of 2019 also saw a continuation of the trend towards lower voluntary repayments for the second series of targeted longer-term refinancing operations (TLTRO-II). The option to make repayments in all four operations on 27 March 2019 was utilised by Eurosystem counterparties to the extent of around €3.4 billion. This was only marginally higher than the repayment in December 2018. As a result, a TLTRO-II volume of around €715 billion is currently still outstanding.

Excess liquidity and money market rates remain in previous range

Excess liquidity continued to move within a narrow range and stood most recently at €1,906 billion. The short-term money market rates likewise saw only minor fluctuations. The unsecured overnight money market rate (EONIA) remained within a range of between -0.36% and -0.37%. Most recently, the secured overnight rate (STOXX GC Pooling) was just under the deposit facility rate at -0.42% and the three-month EURIBOR was virtually unchanged at -0.31%.

Money market forward rates continue to decline

Money market forward rates remained on their downward trajectory, which has been ongoing since October of last year, meaning that the futures curve has continued to flatten significantly overall since the beginning of the year. Since the end of March, the short end of the curve has even been slightly inverted at times, as it is at the moment. As a result, forward rates were lower than the current EONIA level at times. At present, a higher deposit facility rate is – depending on the size of the assumed change in interest rates – factored into forward rates only for the period from the third quarter of 2021 to the third quarter of 2022.[2] Recent surveys also suggest that the expected timing of the first rise in interest rates has shifted markedly into the future. Furthermore, the uncertainty regarding the timing of the first interest rate rise has increased in the surveys. However, it still remains the case that, due to negative term premia, money market forward rates derived from the EONIA swap curve tend to point to a later date for an initial rise in interest rates than surveys.[3]

Monetary policy decisions and communication as drivers of forward rates

The main drivers of this development were, on the one hand, the monetary policy decisions in March. The adjustment of the calendar-based element of forward guidance is likely to have contributed to a further shift in the overall distribution of interest rate expectations. However, at present, expectations are being shaped by the latest economic news and therefore by the state-contingent element of forward guidance. In this context, the downward revisions of the Eurosystem forecasts published following the March meeting are also likely to have affected interest rate expectations. On the other hand, the communication from members of the ECB Governing Council at the end of March as well as corresponding media reports were taken by market participants as a signal that the Eurosystem could be contemplating measures to mitigate any potential side effects of the negative deposit facility rate. Market participants associated the discussions about such measures with a potential prolongation of the low interest rate environment, which postponed the expected timing of the first interest rate rise.

Monetary developments in the euro area

Lending to private sector remains key driver of monetary growth

The robust increase in the broad monetary aggregate M3 continued in the reporting quarter, even though the Eurosystem discontinued its monthly net asset purchases at the end of 2018. At the end of March, the annual growth

2 Estimates as to how large the first interest rate rise might plausibly be can be derived from surveys on interest rate expectations and range from 10 to 25 basis points.
3 For more information on the discrepancy between the time frame for the first interest rate rise derived from money market forward rates and interest rate surveys, see also Deutsche Bundesbank (2018a).

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

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

Assets	Q4 2018	**Q1 2019**
Credit to private non-MFIs in the euro area	66.2	101.7
Loans	60.0	78.7
Loans, adjusted[1]	88.2	74.2
Securities	6.2	23.0
Credit to general government in the euro area	40.7	− 40.2
Loans	4.0	− 6.8
Securities	36.7	− 33.5
Net external assets	35.0	113.6
Other counterparts of M3	22.9	− 6.2

Liabilities	Q4 2018	**Q1 2019**
Holdings against central government[2]	24.1	− 10.9
Monetary aggregate M3	171.5	129.4
of which components:		
Currency in circulation and overnight deposits (M1)	117.4	177.8
Other short-term deposits (M2-M1)	13.7	2.1
Marketable instruments (M3-M2)	40.4	− 50.5
Longer-term financial liabilities	17.5	50.3
of which:		
Capital and reserves	15.5	16.5
Other longer-term financial liabilities	1.9	33.8

* 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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rate of M3 stood at 4.5%. The main drivers of growth remained credit to the domestic private sector on the one hand and inflows of funds from abroad on the other. Demand for credit in the private sector was supported by the ongoing favourable financing terms and the healthy labour market situation in the euro area. Although lending to non-financial corporations was more moderate in net terms than in the preceding quarters, at the same time, enterprises raised more funds on the capital market during the reporting quarter, including from euro area banks. The associated increase in securitised lending meant that net inflows to banks' credit to the private sector rose slightly in comparison with the preceding quarter.

Overnight deposits again main driver of M3 growth; broadly distributed across sectors in first quarter of 2019

Monetary growth in the first quarter of 2019 was driven almost exclusively by the growth in overnight deposits. Alongside households, which traditionally account for the largest inflows, non-financial corporations also substantially increased their overnight deposits at the start of the year; cash holdings and short-term savings deposits likewise saw distinct growth. The opportunity costs of holding cash, which remained comparatively low, are likely to have been a key factor in this development. In addition, the increased uncertainty regarding the economic outlook could have also played a role. By contrast, the other components of M3 – short-term time deposits and marketable instruments – were reduced in net terms.

Securitised lending offsets lower momentum in lending

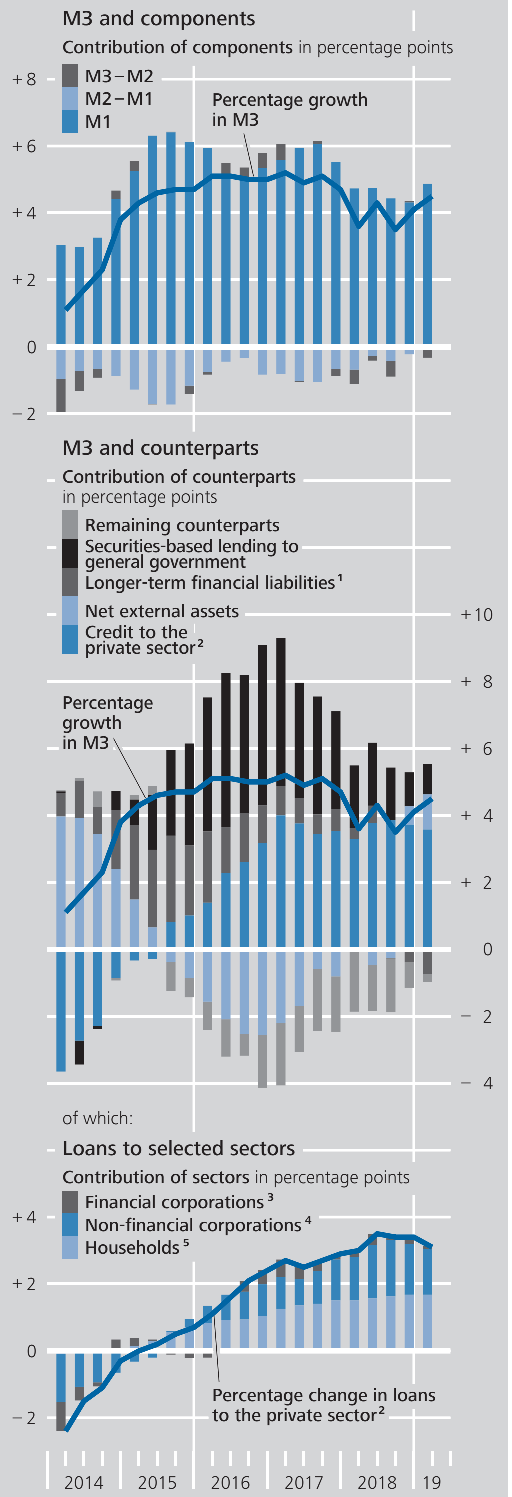
From the counterpart perspective, credit to the domestic private sector again made a significant contribution to monetary growth. During the reporting period, this was attributable not only to loans, but also to securitised lending, particularly in the form of shares and investment fund shares. Overall, this means that the economic slowdown has so far not been entirely reflected in banks' credit to the domestic private sector, even though lending to the private non-financial sector again lost some of its momentum in the reporting quarter.

Weaker lending to non-financial corporations, notably in Italy

This was chiefly due to the fact that net inflows in loans to non-financial corporations slowed down further in the first quarter of 2019. The annual growth rate of these loans fell to 3.5% at the end of March, but was still slightly higher than one year before. As in the previous quarters, growth was driven primarily by large contributions of banks domiciled in Germany and France. In the quarter under review, however, institutions in Spain had also begun to markedly expand their net lending to non-financial corporations. By contrast, Italian banks recorded net outflows in this credit segment for the second time in succession. On the one hand, the recent weak cyclical developments

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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and the subdued growth prospects dampened credit demand in Italy. On the other hand, the latest Bank Lending Survey (BLS) indicates that, against this backdrop, banks in Italy again distinctly tightened their credit conditions overall in the quarter under review.

Lending policies towards enterprises and credit demand virtually unchanged overall

However, according to BLS data, banks' lending policies towards enterprises remained virtually unchanged at the euro area level. According to the bank managers surveyed, demand for loans on the part of enterprises likewise did not change in net terms during the reporting period. However, this was the result of compensatory effects in the reported influencing factors: all other things being equal, the low general interest rate level and the increased financing needs for fixed investment caused demand to rise, while the heightened issuance of debt securities and equity in particular had a dampening effect on demand for loans.

Enterprises' issuing activity on the capital market subdues loan growth

The fact that securitised lending in the MFI sector to the domestic private section grew considerably in the first quarter of 2019 is consistent with this assessment. While the Eurosystem has not increased its stock of corporate bonds any further since the start of the reinvestment phase of the APP in January 2019, banks in the euro area recorded net purchases of both debt securities and shares of domestic enterprises. These inflows are in line with higher net issuance of bonds of non-financial corporations.

Loans to households once again record considerable inflows

Unlike loans to enterprises, lending to households (adjusted for sales and securitisation) recorded considerable inflows in the first quarter, too. This was true for both consumer credit and loans for house purchase; the latter is much larger in terms of volume. The annual growth rate was unchanged at 3.2% at the end of March. Banks in Germany and France, but also Italy, again made the largest contributions to the growth of this credit segment, while lending to households in Spain stagnated further.

As in the previous quarter, the banks surveyed in the BLS reported a marked increase in demand for housing loans in the euro area as a whole, which they mainly attributed to the low general interest rate level. According to the information provided by the bank managers, standards for loans for house purchase tightened marginally on balance for the first time since the beginning of 2016, having been relaxed continuously over the preceding quarters.

Increases in net external assets bolstered by current account surplus

The MFI sector's net external asset position was an important mainstay of monetary growth in the first quarter. The persistent surplus in the euro area's current account likewise paved the way for the inflows of funds from abroad at the beginning of the year. In addition, balance of payments data for January and February indicate that, on balance, non-resident investors acquired a sizeable volume of euro area securities despite the persistently negative yield spread in the euro area relative to most other economic areas. At the same time, domestic investors' demand for securities investments in non-euro area countries remained moderate.

Marked increase in monetary capital owing to longer-term bank bonds

Monetary growth was dampened by comparatively large inflows of monetary capital. Longer-term bank bonds showed an especially sharp increase. This form of financing is likely to have become more attractive to banks in light of the declining maturities of the Eurosystem's longer-term refinancing operations and with a view to locking in interest rates.

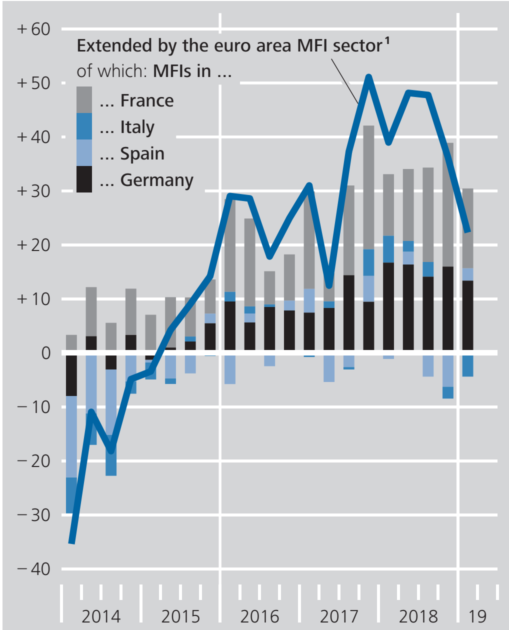
German banks' deposit and lending business with domestic customers

Further strong growth in German banks' deposit business

German banks' deposit business with domestic customers recorded another strong increase in the first quarter of 2019. Again, this was largely thanks to short-term deposits – most notably the persistently strong inflows into overnight deposits. At the same time, unlike in the previous quarters, short-term time deposits remunerating at close-to-market rates and short-

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 to non-financial corporations and quasi-corporations, adjusted for loan sales and securitisation. 1 Also adjusted for positions arising from notional cash pooling services provided by MFIs.
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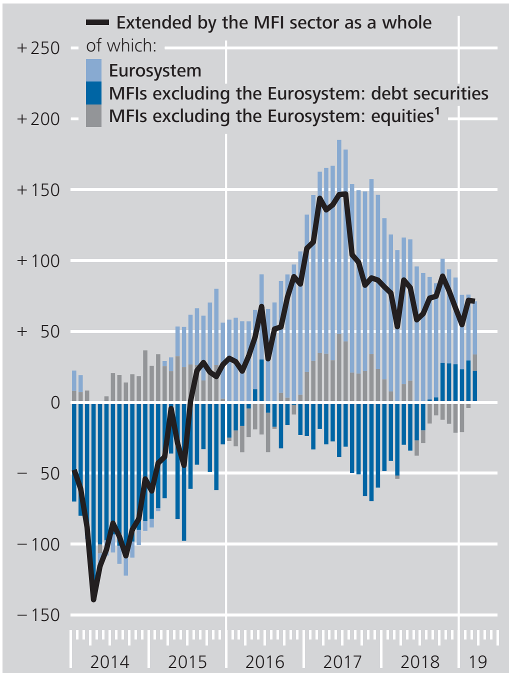
Securities-based lending* to private non-banks in the euro area

€ billion, 12-month accumulated flows



Sources: ECB and Bundesbank calculations. * Eurosystem: debt securities only; other MFIs: debt securities and equities. 1 Shares and other equities.
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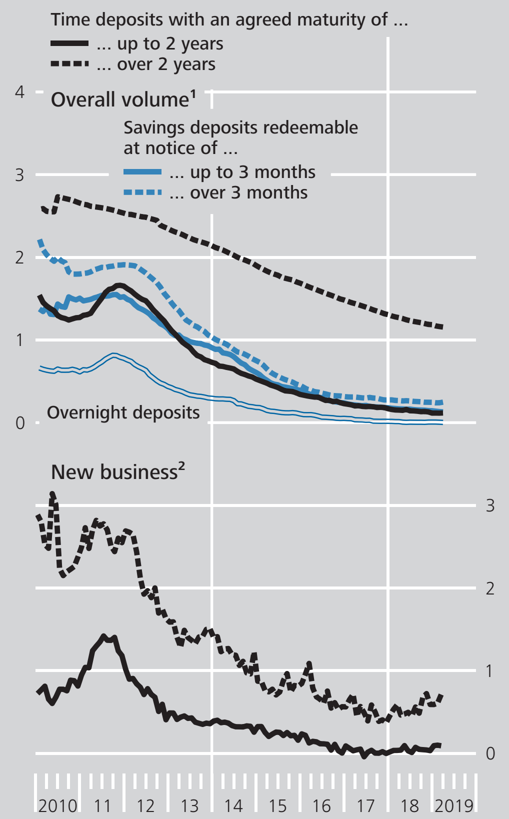
Interest rates on bank deposits in Germany*

% p.a., 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 (i.e. deposit contracts on the balance sheet at the end of the month), the volume of new business (i.e. all contracts concluded in the course of a month) is explicitly recorded for time deposits only.

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term savings deposits expanded markedly, while long-term bank deposits again showed a distinct decline. This development should still be viewed in conjunction with the low interest rate level and the flat yield curve (see the chart above).

Households still primarily responsible for build-up of overnight deposits

Households were again primarily responsible for the strong growth in short-term bank deposits as they boosted their overnight deposits substantially. Non-financial corporations also distinctly stepped up their overnight deposits in the reporting quarter, even though the interest rate on these deposits had already been in slightly negative territory for several quarters. In the reporting quarter as a whole, the financial corporations sector, which traditionally has a greater interest in seeking higher returns, recorded further marked outflows in the case of bank deposits (for background information, see the box entitled "Acquisition of financial assets and the search for yield in Germany" on pp. 31ff.).

Sharp expansion in lending business with non-banks,

Despite the clear slowdown in economic activity in the second half of 2018, banks' lending business with the domestic non-bank sector was exceptionally dynamic in the quarter under review. This was mainly thanks to the sharp expansion in lending to the domestic private sector. By contrast, loans to general government declined again markedly in the reporting quarter as the public sector's financing needs remained low.

… while households record largest net inflows

In terms of lending to the private sector, loans to households once again recorded the largest net inflows. This was primarily due to households' strong demand for housing loans, which expanded significantly once more. As in the previous quarter, the annual growth rate of loans for house purchase came to 4.6% at the end of the quarter.

Credit standards tightened slightly for loans for house purchase for the first time since the third quarter of 2016

The banks surveyed as part of the BLS stated that, as in previous quarters, this first-quarter increase was driven in particular by the low general interest rate level. In addition to this, households view the housing market and house price developments in a positive light. Credit standards for loans to households for house purchase were tightened slightly for the first time since the third quarter of 2016. According to the bank managers surveyed, this was largely because of banks' reduced risk tolerance. With no adjustments being made in the previous quarter either, the period of easing credit standards observed since the beginning of 2017 thus appears to have come to an end for the time being.

Lending to domestic non-financial corporations was another important driver of the growth in

Acquisition of financial assets and the search for yield in Germany

The development of financial investment by the individual money-holding sectors in Germany over recent years indicated that the persistent low interest rate environment was having only a limited impact on the portfolio structure of the private non-financial sector.[1] Despite rising gradually between 2014 and 2017, households' search for yield played a subordinate role overall. Risk aversion and preference for liquidity remained the predominant factors. By contrast, financial corporations[2] exhibited a certain search for yield.

According to the latest data from monetary statistics and financial accounts, these developments generally continued in 2018. Households' bank deposits again saw record inflows last year, making them by far the most important form of investment for this sector (see the chart on p. 32). The inflows were almost entirely attributable to the build-up of overnight deposits, which accelerated further. At the same time, the moderate net reduction in the other types of deposits slowed down. Households' preference for particularly liquid overnight deposits was bolstered by the fact that the interest rate spreads between the different types of deposits remained at historically low levels. Furthermore, claims on insurance corporations represented a major form of investment for households in 2018, although inflows were weaker on the year. The combined, large share of financial asset acquisition accounted for by these two asset classes, which are perceived as being very safe, thus indicates that households are still strongly averse to risk.

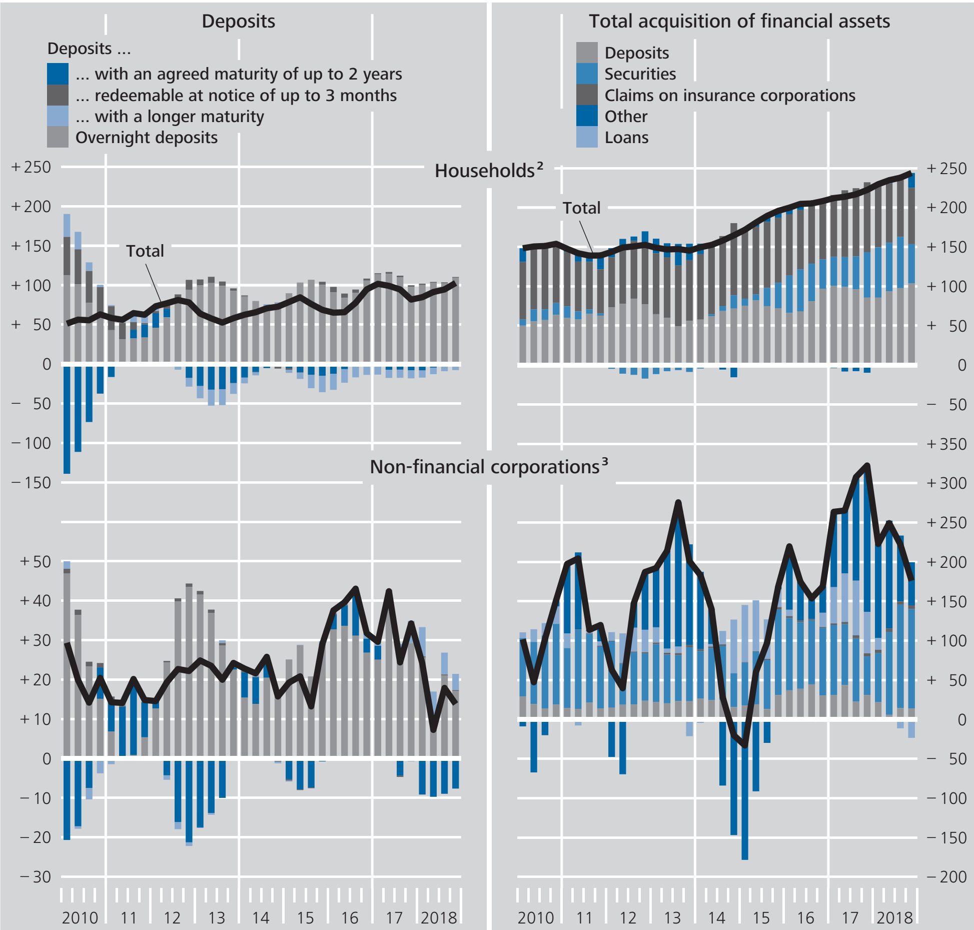
Having risen continuously over the previous years, this sector's capital market investment in 2018 undershot the previous year's level for the first time in five years. In particular, inflows to investment funds from Germany and abroad fell considerably compared with the previous year. However, the acquisition of shares also slowed down markedly, especially towards the end of 2018. By contrast, debt securities recorded net purchases for the first time since 2008, albeit to a fairly limited extent. Taken together, the less favourable developments in the stock markets compared with previous years – and the associated perception of heightened uncertainty regarding future gains on securities – probably contributed to the slight decline in households' willingness to take yield calculations into account when making their investment decisions in the year under review.

After three strong years, the build-up of deposits in the non-financial corporations sector weakened considerably. This was due to the steep drop in inflows, in particular, to overnight deposits held at commercial banks. The short-term types of deposits are likely to have lost much of their appeal due to the cuts in interest rates in recent years, which – unlike in the case of households – are now in negative territory across the board. Non-financial corporations' remaining financial asset acquisition – which is far more important in terms of investment volume – was considerably lower again in 2018 following the very strong inflows one year earlier. A significant part of the funds was invested in equity investments, above all in the form of other equity. Lending,

1 See Deutsche Bundesbank (2018b).
2 For the purpose of this box, financial corporations exclude 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 comparatively 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-end[1]



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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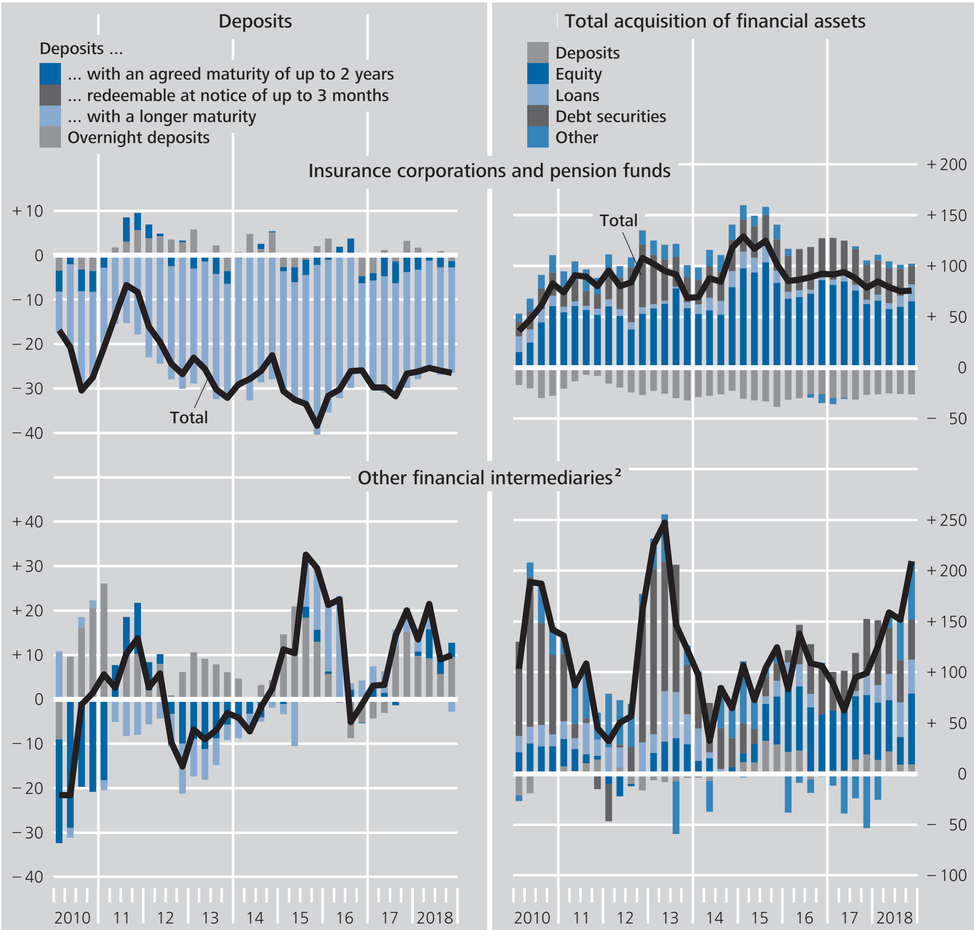
however, was down after performing strongly the year before. In particular, intra-sectoral loans and loans to non-euro area countries experienced a decline. As in previous years, strategic participations thus appear to have been the main driver of investment decisions made by German non-financial corporations. By contrast, the preference for liquid and safe financial investments receded slightly.

Within the financial sector, insurance corporations and pension funds continued in unmodified form their strong reduction of longer-term bank deposits in particular, which began in 2010. Once again, it was chiefly banks' registered debt securities and borrowers' note loans, which for statistical purposes are considered as time deposits, that were pared back. Compared with previous years, insurance corporations and pension funds shifted the composition of their new investments more heavily towards less liquid, higher-yielding financial instruments. Above all, net purchases of unlisted shares as well as the granting of (non-tradable) loans increased noticeably. By contrast, the acquisition of investment fund shares was somewhat less pronounced compared with the previous year. Neverthe-

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

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



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

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less, as in the years before, it accounted for a large portion of the financial assets acquired by this sub-sector (see the chart above). The build-up of holdings of debt securities slackened pace, too, and the impact was felt across all sectors both at home and abroad.

Securities also accounted for the largest portion of the total sectoral financial assets acquired by other financial institutions.[3] The listed shares of non-financial corporations recorded particularly strong inflows. By contrast, purchases of investment fund shares were significantly weaker in 2018 than in previous years. Net purchases of debt securities likewise decreased somewhat. At the same time, funds directly invested in securities shifted clearly away from foreign to domestic paper. One factor to bear in mind in this connection is that the Eurosystem halved the volume of its monthly net purchases of domestic sovereign and corporate bonds at the beginning of 2018, and reduced it again significantly in the fourth quarter. Furthermore, lending by other

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

financial institutions, notably to non-financial corporations in the euro area, rose appreciably. Inflows of deposits, which were lower than inflows channelled to other financial assets, fell short of the previous year's figure. This was partly due to the reduced build-up of overnight deposits by investment funds and partly the result of the slight contraction in the longer-term time deposits of financial vehicle corporations (FVCs).[4]

Overall, the developments seen in the previous years continued in 2018. In the case of households, investment decisions were again shaped by risk aversion and a preference for liquidity. Generally speaking, yield aspects had been taken into consideration to a greater extent from 2014 onwards. However, households' capital market exposure weakened again somewhat in 2018 due, in part, to the unfavourable stock market developments. While the acquisition of strategic stakes was the main driver of financial investment for non-financial corporations, the continued scaling back of deposits and the shift towards less liquid instruments among financial corporations pointed to a certain degree of searching for yield.

4 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 FVC for those securitised loans, typically as a long-term liability of the bank to that FVC.

Renewed noteworthy increase in lending to non-financial corporations …

German banks' lending business in the quarter under review. Despite recent subdued economic activity, the net increase in this credit segment was markedly higher than in the final quarter of 2018. Owing to a negative base effect, the annual growth rate for loans to non-financial corporations nevertheless fell slightly to 5.1% in the reporting quarter.

… driven by longer-term loans

Enterprises again showed a greater preference for longer-term loans in order to finance their longer-term, typically larger-scale investment projects. By contrast, shorter-term loans recorded modest outflows, as in the preceding quarter. This development suggests that German enterprises are still relying more heavily on their own funds and/or alternative sources of funding to finance their short-term expenditure.

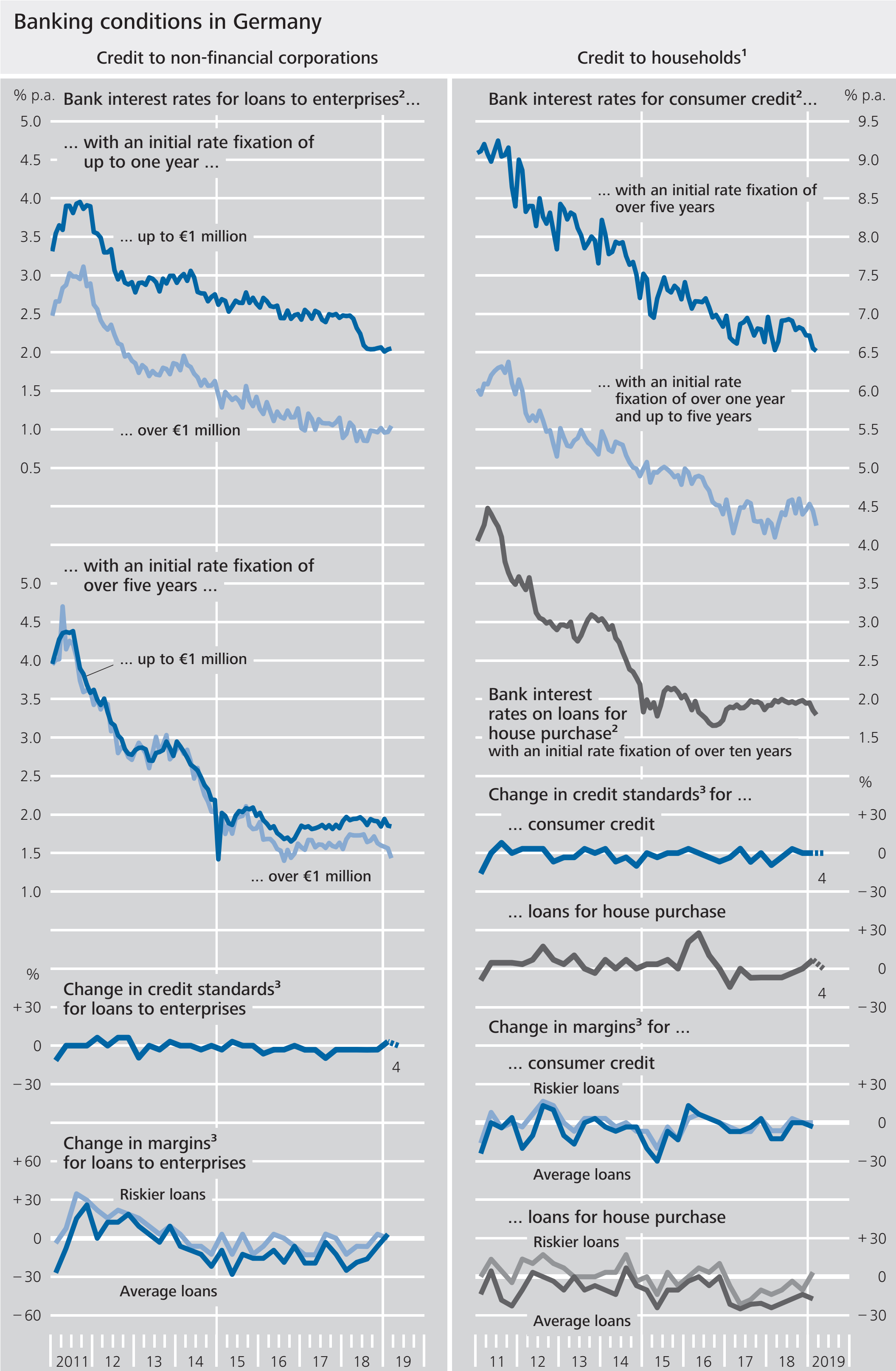
The results of the BLS largely support this view. According to bank managers, the rise in demand for loans to enterprises was mainly attributable to increased financing needs related to fixed investment. By contrast, taken in isolation, enterprises' recourse to alternative sources of funding continued to have a dampening effect on demand. The responses from the latest BLS do not indicate any major changes to the lending policies of the surveyed banks. Nevertheless, they suggest that the period of expansionary adjustments in lending policy has initially come to a halt for loans to enterprises, too.

According to BLS, rise in demand due to financing needs for fixed investment, in particular; easing of lending policy initially at an end

German banks' profitability dented by APP and negative deposit facility rate

In the longer term, i.e. relative to the midpoint of the range set by the standards implemented since 2003, banks reported their current credit standards for loans to enterprises and for consumer credit and other loans as being somewhat tighter, and those for loans to households for house purchase as being considerably tighter.

Banks reported that, over the last six months, the Eurosystem's expanded APP had improved



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 Q2 2019.

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Lending and deposits of monetary financial institutions in Germany*

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

Item	2018 Q4	2019 Q1
Deposits of domestic non-MFIs[1]		
Overnight	41.0	43.0
With an agreed maturity of		
up to 2 years	− 2.9	9.8
over 2 years	− 0.5	− 9.4
Redeemable at notice of		
up to 3 months	− 0.3	3.9
over 3 months	− 1.5	− 0.1
Lending		
to domestic general government		
Loans	− 0.1	− 4.1
Securities	− 5.9	− 1.8
to domestic enterprises and households		
Loans[2]	23.1	34.0
of which: to households[3]	16.2	18.2
to non-financial corporations[4]	7.2	11.9
Securities	− 2.6	− 0.7

* 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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their liquidity position but continued to erode their profitability. Through its impact on net interest income, the negative interest rate on the deposit facility likewise put discernible pressure on banks' profitability over the past six months. As well as directly affecting banks' interest expenditure via excess liquidity holdings, this is also likely to have had indirect effects. These indirect effects may stem, inter alia, from the fact that banks' margins are being squeezed owing to their reluctance to further reduce interest rates on deposits – especially those of households – for fear of potential withdrawals. Banks can try to counteract this strain on their profitability by expanding their credit volume.

List of references

Deutsche Bundesbank (2018a), Monetary policy and banking business, Monthly Report, August 2018, p. 26.

Deutsche Bundesbank (2018b), Acquisition of financial assets and the search for yield in Germany, Monthly Report, May 2018, pp. 30-33.