Monetary policy and banking business

Monetary policy and money market developments

ECB Governing Council twice adjusts forward guidance

The Governing Council of the ECB used its monetary policy meetings in June and July 2019 to further adjust its forward guidance on key interest rates. The ECB's main decision-making body now expects key interest rates to remain at their present or lower levels at least through the first half of 2020, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels below, but close to, 2% over the medium term. Forward guidance regarding the reinvestment of securities acquired as part of the expanded asset purchase programme (APP) was left unchanged at both meetings. Key interest rates also remained unadjusted in the period under review, meaning that the main refinancing rate is still 0%, while the rate on the marginal lending facility stands at 0.25% and the deposit facility rate at -0.40%.

ECB Governing Council decides on further key parameters of TLTRO III

The Governing Council also used its June session to decide on the key parameters, including the interest rates charged, for the new series of targeted longer-term refinancing operations (TLTRO III) announced in March 2019. It was decided that the interest rate for each operation will be set at a level of 10 basis points above the average rate applied to the Eurosystem's main refinancing operations (MROs) over the life of the respective TLTRO. For banks whose eligible net lending exceeds a certain benchmark, the rate applied can be as low as the average interest rate on the deposit facility prevailing over the life of the respective operation plus 10 basis points.[1]

Measures designed to ensure sustained convergence of inflation

The monetary policy decisions taken in June aimed to continue providing the degree of monetary accommodation necessary for inflation to remain on a sustained path towards levels that are below, but close to, 2% over the medium term. The Governing Council took the view that although the data for the first quarter were somewhat better than expected, the information available up to the June meeting indicated that global headwinds were continuing to cloud the euro area outlook. Incoming information since the June meeting of the Governing Council likewise indicates that, while further employment gains and increasing wages continue to underpin the resilience of the economy, softening global growth dynamics and weak international trade are still weighing on the euro area outlook. The prolonged presence of uncertainties, related to geopolitical factors, the rising threat of protectionism, and vulnerabilities in emerging markets, is dampening economic sentiment, notably in the manufacturing sector. In this environment, inflationary pressures remain muted and indicators of inflation expectations have declined.

ECB Governing Council tasks committees with examining options

Against this backdrop, the Governing Council in July signalled its readiness to adjust all of its monetary policy instruments, as appropriate, to ensure that inflation moves towards its aim in a sustained manner. In this context, the Governing Council tasked the relevant Eurosystem Committees with examining options.

Little change in securities holdings recognised on balance sheet

The stock of APP assets recognised on the balance sheet continued to fluctuate slightly during the reporting period. This was due to two factors: the smoothing over time of reinvestments in line with the technical parameters agreed upon in December, and the use of amortised cost accounting.[2] As at 9 August 2019, the stock of APP assets held by the Eurosystem came to a total of €2,551 billion (a breakdown of these holdings by individual asset purchase programme can be found on p. 25).

1 Further information on TLTRO III can be found in the ECB's press release of 6 June 2019.
2 In particular, the difference between an asset's acquisition and redemption value is amortised over the residual maturity, treated as part of interest income and thus measured at (amortised) cost.

Money market management and liquidity needs

The two reserve periods between 17 April 2019 and 30 July 2019 saw a slight increase in euro area liquidity needs stemming from autonomous factors (see the table below). In the June-July 2019 reserve period, these liquidity needs averaged €1,418.6 billion, which was €55.3 billion higher than the average level in the March-April 2019 period, the last reserve maintenance period prior to the reporting period. Overall, in the two periods under review, the sum of the autonomous factors fluctuated within a broad corridor of between €1,296.0 billion and €1,480.8 billion. The increase in government deposits with the Eurosystem and the higher volume of banknotes in circulation were the main factors behind the additional liquidity needs. Public sector deposits stood at €295.9 billion on average in the June-July 2019 reserve period, which was €25.4 billion higher than the average figure for the March-April 2019 reserve period. There was also a corresponding rise in banknotes in circulation, with an average of €1,240.8 billion in circulation in the June-July 2019 reserve period, €25.0 billion higher than the average level in the March-April 2019 reserve period. Banknotes in circulation thus remain by far the largest liquidity-absorbing autonomous factor in the Eurosystem (see the chart on p. 25). Furthermore, the combined changes of net foreign assets and other factors, which are considered together as a result of liquidity-neutral valuation effects, increased liquidity needs by €4.9 billion. In addition to the autonomous factors, the calculated need for central bank liquidity also rose as a result of the higher minimum reserve requirement, which came in €3.0 billion higher at €131.4 billion in the June-July 2019 reserve period.

Factors determining banks' liquidity*

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

Item	2019 17 April to 11 June 2019	 12 June to 30 July 2019
I. Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors		
1. Banknotes in circulation (increase: –)	– 12.4	– 12.6
2. Government deposits with the Eurosystem (increase: –)	+ 22.3	– 47.7
3. Net foreign assets[1]	+ 11.1	+ 20.6
4. Other factors[1]	– 6.3	– 30.3
Total	+ 14.7	– 70.0
II. Monetary policy operations of the Eurosystem		
1. Open market operations		
(a) Main refinancing operations	– 0.2	– 0.9
(b) Longer-term refinancing operations	– 1.7	– 18.5
(c) Other operations	– 5.3	– 10.2
2. Standing facilities		
(a) Marginal lending facility	+ 0.3	– 0.4
(b) Deposit facility (increase: –)	+ 17.7	+ 31.1
Total	+ 10.8	+ 1.1
III. Change in credit institutions' current accounts (I. + II.)	+ 25.6	– 68.9
IV. Change in the minimum reserve requirement (increase: –)	– 0.4	– 2.6

* 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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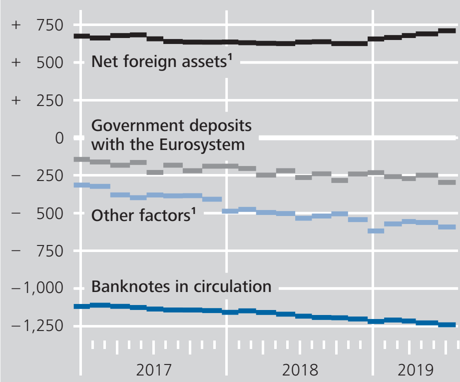
The outstanding tender volume from the Eurosystem's open market operations continued to decline during the reporting period. In the June-July 2019 reserve period, the figure averaged around €705 billion, which was roughly €21 billion lower than in the March-April 2019 period. This decline was attributable, in particular, to voluntary early repayments on the second series of targeted longer-term refinancing operations (TLTRO II). The TLTRO II repayments made at the end of June amounted to a total of €25.9 billion, which is more than on previous dates. The total amount still outstanding on all four TLTRO II operations now stands at around €689 billion. But demand continued to decline for the regular tender operations as well, with the volume of main refinancing operations in the June-July 2019 reserve period falling to an average of €4.6 billion, down €1.1 billion on the March-April 2019 reserve period. In addition, the outstanding volume of three-month tenders fell to an average of €3.3 billion in the June-July 2019 reserve period, down by €0.3 billion on the March-April 2019 reserve period.

With a share of almost 80% in the period under review, the asset purchase programmes continue to constitute the bulk of Eurosystem central bank liquidity provided through open market operations. The average balance sheet holdings of all purchase programmes in the June-July 2019 reserve period amounted to €2,620 billion, down by €16 billion on the March-April 2019 reserve period, when average holdings amounted to €2,636 billion. This was caused by amortisation adjustments, maturities and flexibility in terms of reinvestment (see the adjacent table). The public sector purchase programme (PSPP) accounted for 80% of holdings of all purchase programmes. As a result of the reduction in securities holdings and the lower tender volume in the period under review, central bank liquidity supplied by means of open market operations declined once again, as it had in the two preceding periods (see the chart on p. 27).

This lower provision of liquidity and the increased liquidity needs stemming from autonomous factors reduced excess liquidity in the Eurosystem to an average of €1,775 billion in the June-July 2019 reserve period, which was €95 billion lower than in the March-April 2019 reserve period. In the intervening April-June 2019 reserve period, excess liquidity was still distinctly higher, averaging €1,877 billion. All in all, excess li-

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 9 August 2019
Active programmes[1]		
PSPP	− 10.1	2,086.9
CBPP3	− 0.9	260.7
CSPP	− 0.5	177.2
ABSPP	− 0.2	26.3
Completed programmes		
SMP	− 7.9	54.9
CBPP1	− 0.6	2.8
CBPP2	− 0.3	3.4

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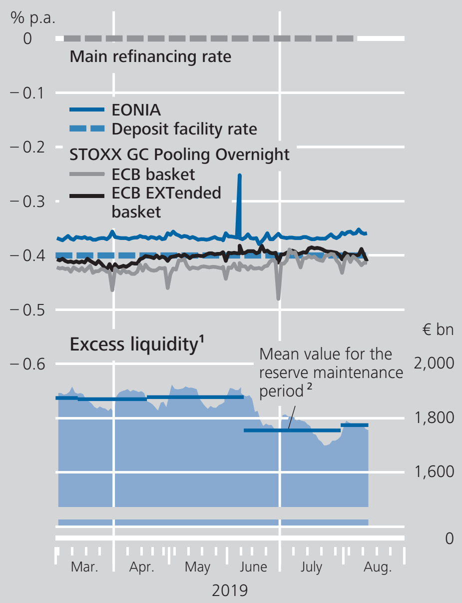
Central bank interest rates, money market rates and excess liquidity

Daily data



Sources: ECB, Eurex Repo and Bundesbank calculations. **1** Current account holdings minus the minimum reserve requirement plus the deposit facility. **2** The last period displayed is still ongoing.
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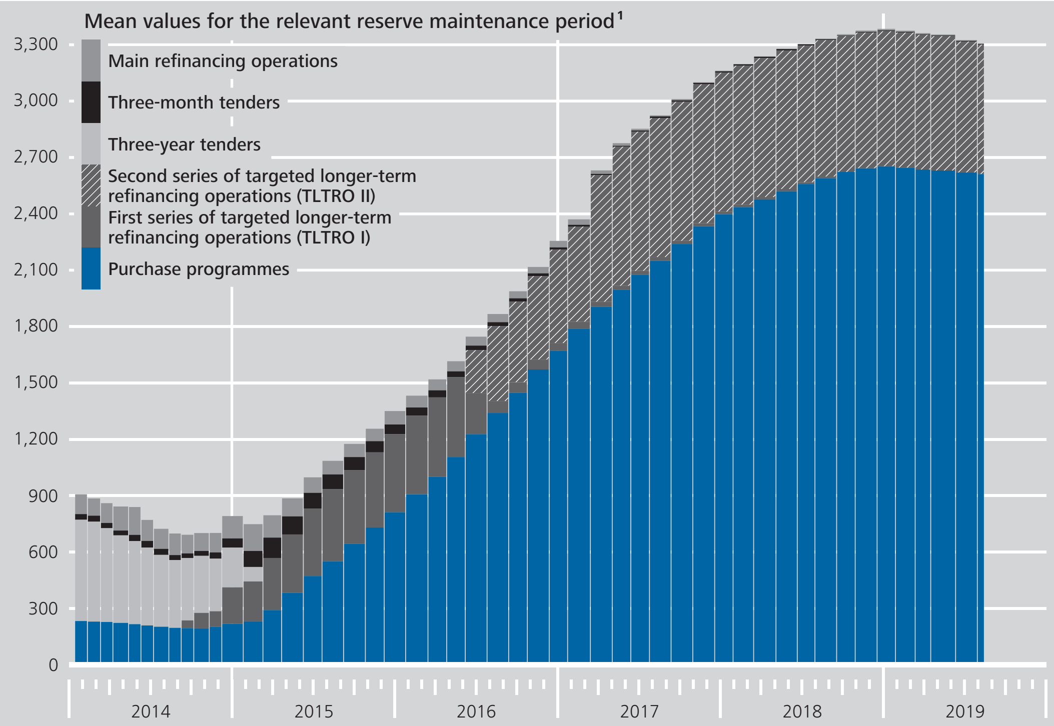
quidity at the end of the period under review was thus somewhat lower than over the course of 2018 and in the first half of 2019. From September 2019, the third series of targeted longer-term refinancing operations (TLTRO III) scheduled to be launched that month should per se drive excess liquidity levels higher. However, the resulting net liquidity effect will depend on the degree to which participating institutions simultaneously roll over TLTRO II funding when making voluntary early repayments.

The very comfortable liquidity conditions continued to ensure that overnight euro money market rates stayed close to the deposit facility rate (see the above chart). EONIA, the reference rate for unsecured overnight money, averaged -0.37% in the June-July 2019 reserve period (previous reserve period April-June 2019: -0.36%). At an average of €2.6 billion, the underlying EONIA turnover in the same reserve period remained low (previous reserve period April-June 2019: €2.0 billion). However, on 7 June there was an unexpected rise in the EONIA rate to -0.25%, though this was a one-off effect facilitated by the low trading volume, which stood at €0.6 billion.

Secured overnight money, on the other hand, mainly traded below the deposit facility rate in the two reserve periods under review. On the GC Pooling platform, overnight trades in the ECB basket were executed at -0.41% on average in the June-July 2019 reserve period, which was 2 basis points higher than in the March-April 2019 reserve period. Overnight money in the ECB EXTended basket, with its larger set of eligible securities, traded at -0.39% on average in the June-July 2019 reserve period, which was also higher than in the March-April 2019 reserve period, when the corresponding rate was -0.42%. Aggregate overnight turnover across both segments in the June-July 2019 reserve period amounted to an average of €9.9 billion; as such, it exceeded the March-April 2019 reference period level of €9.1 billion, and remained clearly above the EONIA turnover.

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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TLTRO II repayments far higher

Voluntary repayments on the second series of targeted longer-term refinancing operations (TLTRO II) in June were distinctly higher than in previous quarters. Eurosystem counterparties took up the opportunity to make repayments on all four operations on 27 March to the tune of around €25.9 billion. The bulk of this amount, roughly €21.2 billion, was accounted for by repayments on the first operation, whose residual maturity dropped below one year in June. This left this particular operation less eligible under the liquidity regulations, making it less attractive for banks to hold. At present, a TLTRO II volume of around €689 billion is still outstanding.

Excess liquidity down slightly

Excess liquidity was down overall, coming in roughly €130 billion lower at €1,775 billion as this report went to press. Repayments on TLTRO II operations played only a minor role in this decline, which was driven instead primarily by a rise in autonomous factors, notably government deposits with the Eurosystem (see the box on pp. 24 f.).

Three-month EURIBOR hits new all-time low

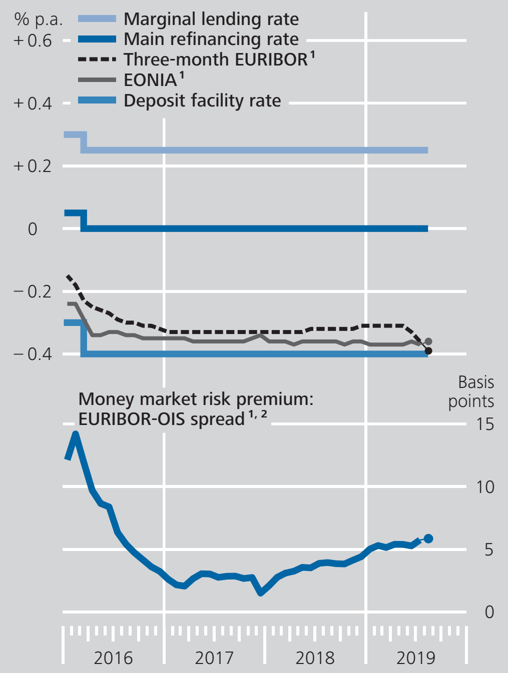
As for short-term money market rates, the unsecured overnight money market rate (EONIA) stayed within its previous range, hovering between -0.36% and -0.37%, while the three-month EURIBOR has registered a noticeable drop since mid-June, hitting a new all-time low of -0.40% as this report went to press. This decline is likely to have been driven primarily by market expectations that the deposit facility rate would be reduced later in the year (see the next paragraph).[3]

Money market forward rates sharply lower

Money market forward rates fell sharply overall during the period under review, just as they had done in the preceding months. The yield curve has been persistently heavily inverted

3 Another factor may have been the switch to the new hybrid methodology for calculating EURIBOR, which the European Money Markets Institute (EMMI), in its capacity as the EURIBOR provider, began to gradually roll out in July.

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 14 August 2019.
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since mid-June in the short and medium-term segments, meaning that forward rates up to 24 months ahead are languishing far short of the current EONIA rate, dipping as low as -0.73% at times. The curve has experienced distinct volatility of late. However, depending on the horizon in question, negative term premia might mean that actual expectations of a cut in policy rates are in fact weaker than the money market forward rates derived from the EONIA swap curve would suggest. Recent surveys of market participants indicate that a majority have strong expectations of a cut in the deposit facility rate, which were much less apparent in previous months.

Monetary policy communication the main driver of forward rates

Monetary policy communication in the euro area and the United States played a notable role in determining the path of money market forward rates. They declined sharply, for instance, following a speech by the ECB President on 18 June in Sintra hinting at a possible further loosening of monetary policy. Similarly, the language which the US Fed chose to use ahead of its policy rates decision on 31 July also swayed market expectations surrounding further monetary policy decisions by the Eurosystem. Furthermore, the state-contingent element of the Eurosystem's forward guidance continues to have a major bearing on money market forward rates, acting to amplify expectations of a cut in rates when incoming economic data are perceived to be weak.

Monetary developments in the euro area

Q2 2019 sees continued robust monetary growth

The broad monetary aggregate M3 registered further strong inflows in the second quarter, continuing its robust expansion with an annual growth rate of 4.5% at the end of June. Major forces of growth, as hitherto, were loans to the domestic private sector and inflows from abroad fuelled by the brisker demand for investments in Germany among non-residents. As yet, the slowdown in euro area activity has not dampened credit growth in most countries, though the latest Bank Lending Survey (BLS) does reveal that credit standards and credit terms and conditions for loans to enterprises in the euro area were tightened overall in the reporting quarter.

Overnight deposits again main driver of M3 growth

As hitherto, monetary growth in the second quarter of 2019 was driven primarily by the increase in overnight deposits. Most of the other sub-components of M3 also registered inflows on balance in the reporting quarter, but these were small by comparison with the overnight deposits. In a continuation of a long-standing trend, households again accounted for by far the strongest inflows into the deposits component of M3 during the second quarter of the year. Amid narrow interest rate spreads for the different types of deposit and elevated uncertainty surrounding the economic outlook, exposures with the shortest-possible maturities continued to attract the most attention in this risk-averse investor group.

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

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

Assets	Q1 2019	Q2 2019
Credit to private non-MFIs in the euro area	107.6	122.9
Loans	83.0	110.3
Loans, adjusted[1]	78.7	131.9
Securities	24.5	12.6
Credit to general government in the euro area	– 40.4	– 56.3
Loans	– 6.8	– 1.2
Securities	– 33.6	– 55.3
Net external assets	111.9	111.4
Other counterparts of M3	– 5.5	39.4

Liabilities	Q1 2019	Q2 2019
Holdings against central government[2]	– 11.1	– 7.8
Monetary aggregate M3 of which components:	133.9	171.5
Currency in circulation and overnight deposits (M1)	185.9	143.6
Other short-term deposits (M2-M1)	3.5	16.7
Marketable instruments (M3-M2)	– 55.5	11.2
Longer-term financial liabilities of which:	50.8	53.5
Capital and reserves	16.6	35.3
Other longer-term financial liabilities	34.3	18.2

* 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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Loans to non-financial corporations register strong inflows

From the counterpart perspective, loans granted to the domestic private sector, adjusted for loan sales and securitisation, contributed most to monetary growth, climbing to an annual growth rate of 3.5% at the end of June, which was just 1 percentage point short of the annual M3 rate. Loans to non-financial corporations, in particular, bounced back from a weaker first quarter to register strong growth in the three months under review; the annual growth rate for these adjusted loans rose slightly to 3.8%. Credit institutions resident in Germany and France were mainly responsible for the inflows, while institutions in Spain and above all Italy recorded net outflows in this credit segment.

Tighter credit standards and brisker demand for loans to enterprises

Bank responses to the BLS confirm that corporate demand for credit across the euro area as a whole increased again on balance in the second quarter of 2019 after remaining unchanged in the first three months of the year for the first time since 2015. Major factors driving aggregate demand were the increased financing needs for fixed investment in many Member States and for mergers, acquisitions and restructurings. Demand also continued to be stimulated by the persistently low general level of interest rates. Banks in Spain were alone among institutions from the four largest euro area countries in reporting a protracted drop in demand. According to the banks surveyed in the BLS, lending standards for loans to enterprises for the euro area as a whole were tightened for the first time since the end of 2016. Standards were tightened particularly strongly in Italy.

Loans to households see continued inflows

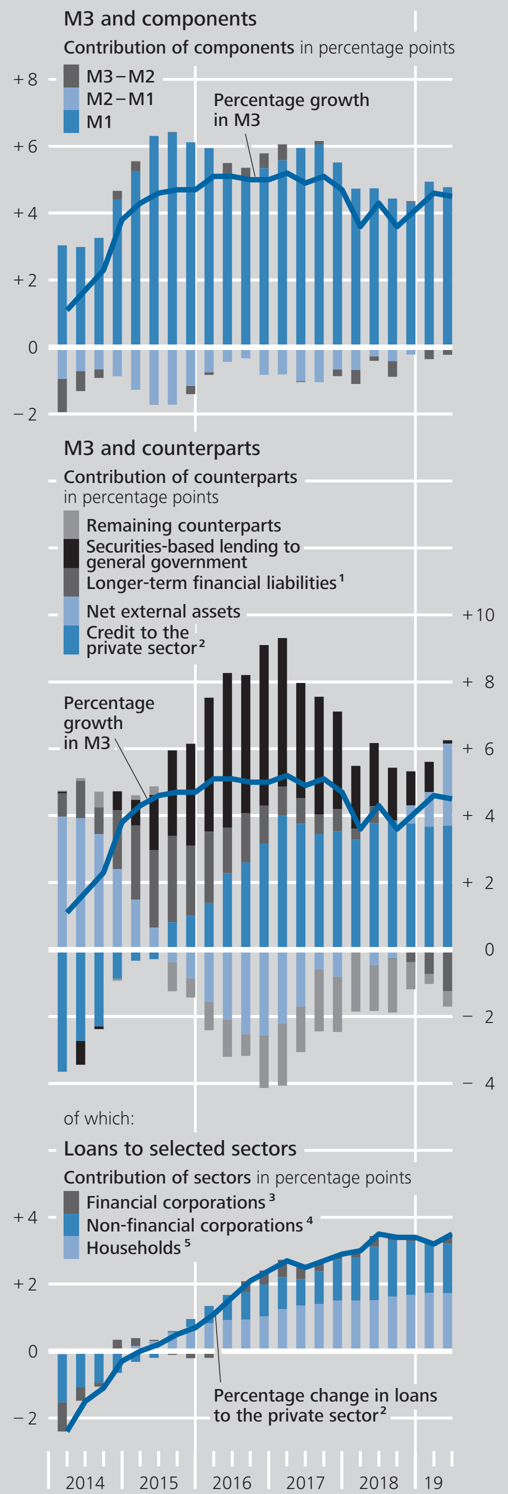
Adjusted for sales and securitisation, loans to households continued to record net inflows in the second quarter. These inflows were observed both in consumer credit as well as in loans for house purchase, which are more significant in terms of volume. At 3.3% at the end of June, the annual growth rate remained unchanged on the previous quarter. The highest net inflows in this credit segment were accounted for by banks in France and Germany. Banks in Italy also made a distinct contribution to the increase, while net lending among banks in Spain remained subdued.

Rise in demand for loans for house purchase

In particular, the banks in the euro area participating in the BLS attributed the renewed rise in demand for housing loans to the low general interest rate level and the positive outlook for both the residential property market and its price movements. According to the institutions' responses, demand-dampening effects stemmed from the equity financing of residential property through the use of savings. Based on the survey results, standards for loans for

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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house purchase in the euro area remained essentially unchanged during the reporting period, after having been tightened again in the preceding quarter for the first time since the beginning of 2016.

M3 growth bolstered by demand for domestic securities among foreign investors

In the reporting quarter, the net external asset position of the MFI sector again clearly helped bolster monetary growth. This was due not only to the euro area's sustained current account surplus, but also the increasingly positive balance of portfolio investment. According to the non-seasonally adjusted balance of payments figures available for April and May, foreign investors in particular made net purchases of both bonds issued by domestic general government as well as shares and mutal fund shares issued by the domestic private sector. By contrast, resident investors' interest in foreign debt instruments was markedly lower during this period. Against the background of the persistently negative yield spread in the euro area vis-à-vis most other economic areas, the reduced political uncertainty in the euro area compared with the end of 2018 is likely to have contributed to the positive financial account balance and subsequently to monetary growth.

Restraining influence on M3 from inflows of capital and reserves

As in the previous quarter, monetary growth was dampened by comparatively large inflows of longer-term financial liabilities. These were attributable to increases in capital and reserves in the MFI sector on the one hand and to a rise in longer-term deposits on the other. By contrast, longer-term bank debt securities were – after very significant inflows in the previous quarter – scaled back slightly in net terms. It is conceivable that banks' interest in this form of financing, which had grown again in the preceding quarters, declined as a result of the new series of TLTROs announced by the Eurosystem.

Securities-based lending has dampening impact on M3 in net terms

In the reporting quarter, securities-based lending in the MFI sector also had a dampening impact on monetary growth in net terms. Since the Eurosystem ceased its monthly net asset purchases at the end of 2018, securities-based lending to domestic general government has recorded continued net outflows. Furthermore, banks recently made slight reductions in their holdings of equities and mutual fund shares again following the very strong inflows in the previous quarter. In the reporting quarter, only bonds and debt securities issued by the domestic private sector were acquired by banks on a notable scale on balance.

German banks' deposit and lending business with domestic customers

German banks' deposit business still dominated by build-up of overnight deposits

German banks' deposit business with domestic customers in the second quarter of 2019 was again dominated by sustained inflows into short-term bank deposits – particularly overnight deposits. These were mainly accounted for by households. Their preference for highly liquid forms of investment continued against the backdrop of the persistently low interest rate level (see the chart on p. 36) and the flat yield curve (see the box on pp. 32 ff.). While the other money-holding sectors also continued to expand their holdings of overnight deposits overall in the reporting quarter, the attractiveness of this form of deposit is likely to have diminished due to the decline in interest rates – including into negative territory – that has occurred over recent years in the corporate banking segment. Long-term bank deposits were reduced further in net terms. This was due to decisions taken by financial corporations, which generally take greater account of yield aspects.[4]

Strong expansion in credit business with non-banks

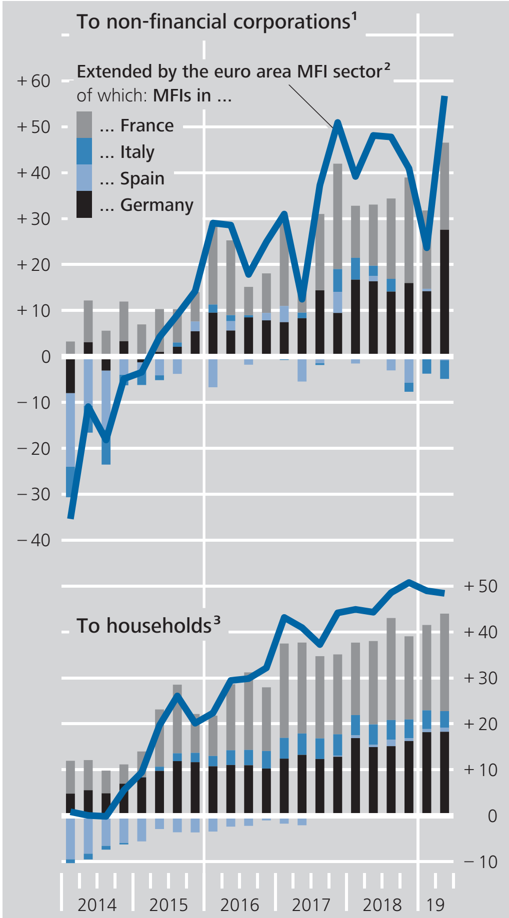
Banks' credit business with the domestic non-bank sector again saw strong expansion in the reporting quarter. This was mainly thanks to the sharp growth in lending to the domestic private sector. By contrast, loans to general government declined once again due to the public sector's low financing needs.

Strong inflows to loans to non-financial corporations …

In terms of loans to the private sector, lending to domestic non-financial corporations recorded the largest net inflows in the reporting quarter. Although economic activity in Germany slowed down, credit dynamics, which had been somewhat subdued in the second half of 2018, have since briskly picked up pace again. The annual growth rate of loans to domestic enterprises, which stood at 5.7% at the end of June, almost caught up with the previous year's level. With regard to maturities, domestic enterprises continued to show a stronger preference for long-term loans, which are often used to finance longer-term and generally higher-volume investment plans. More-

Loans to the private non-financial 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.
Deutsche Bundesbank

4 For background information, see Deutsche Bundesbank (2019b).

Developments in the real portfolio returns of households in Germany

Nominal interest rates in Germany are still at an all-time low, and the slim nominal return on bank deposits, the asset class that traditionally accounts for a significant share of households' financial assets in Germany, is attracting particular public attention. The nominal remuneration on such assets has been hovering close to zero over the past few years, meaning that, when viewed in isolation, it has been depressing the return that households can earn on their aggregate portfolio of financial assets.

Interest payments are ultimately the only source of income a bank deposit can generate; for other types of financial asset, such as shares, debt securities, investment fund shares and claims on insurance corporations, however, income flows are influenced significantly by price effects. The dividends usually paid by shares and investment funds that invest in equities need to be borne in mind, too. Any attempt to calculate households' real total portfolio return thus needs to consider not just interest payments but these other components as well.

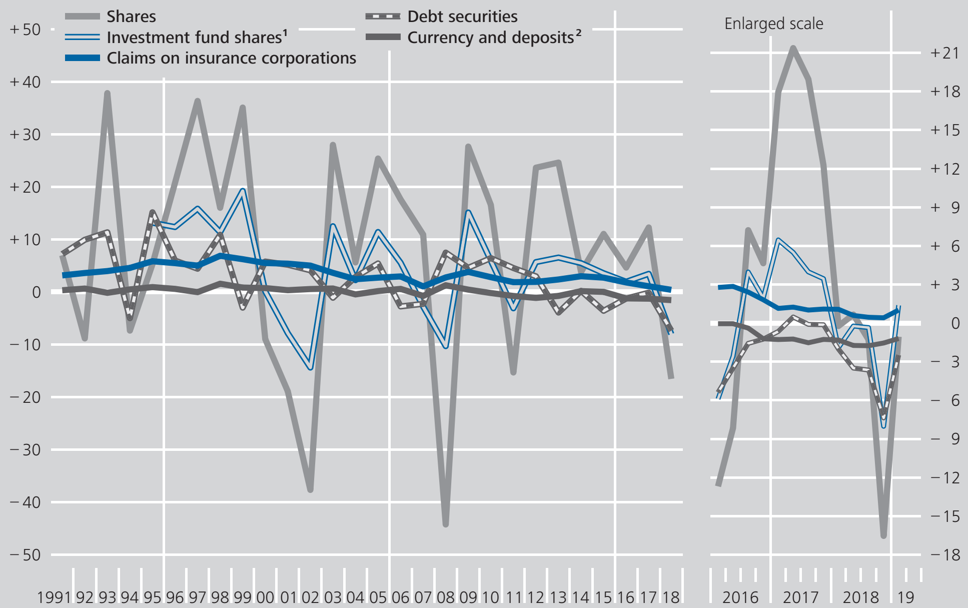
This box outlines how returns on the various financial assets held by households and the total return have evolved up until the first quarter of 2019. The analysis takes into account that the purchasing power of nominal returns fluctuates in line with the inflation rate. This means that all the returns are analysed in real terms.[1]

The chart below depicts the evolution of real returns on the main types of financial

1 A detailed account of how real returns are calculated can be found in Deutsche Bundesbank (2015).

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

% p.a., end-of-year / end-of-quarter data



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

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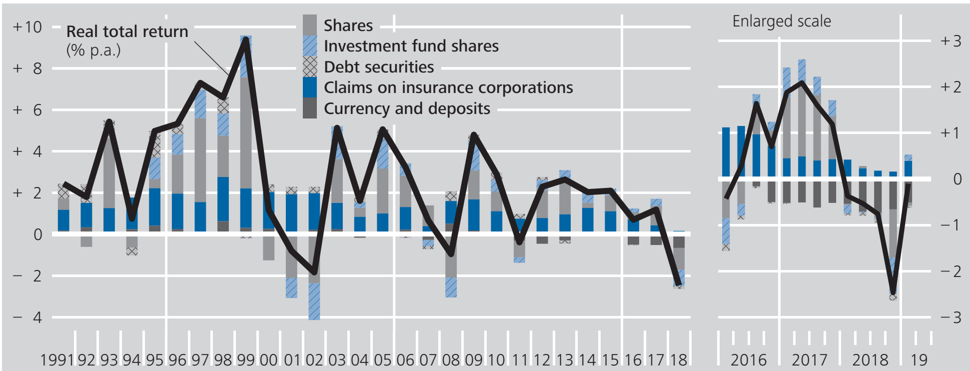
Contributions of individual types of financial asset* to the real total return of households in Germany

Percentage points, end-of-year / end-of-quarter data



* Weighted according to share of total financial assets. Adjusted for inflation using the consumer price index (CPI).
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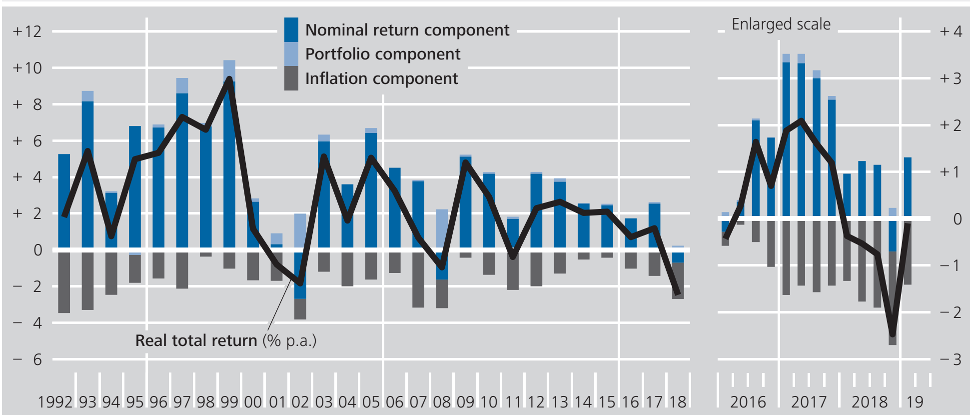
asset in the portfolio of households in Germany between 1991 and the first quarter of 2019.[2] For much of that period, currency and deposits (which presently account for roughly 40%, or the bulk, of financial assets) generally yielded a low real return that was relatively immune to volatility. While there have also been instances in the past when the real return on these financial assets dropped below zero, ever since mid-2016 it has been mired deep in the red for quite some time now. The situation is similar for debt securities, whose return over the past few years has likewise been almost consistently negative in real terms, not least due to the impact of the Eurosystem's asset purchase programme. As for insurance claims, a dwindling inflation rate helped the real return recover slightly from the historic low it recorded in the previous quarter. With a lacklustre stock market setting giving way to rising capital market prices at the end of 2018, the first quarter of 2019 saw returns on shares and investment fund shares put a stop, for now, to the trend decline they had been charting since the beginning of 2017. One likely reason for the upbeat equity market performance of the

2 The following is an updated version of the box from the August 2018 edition of the Bundesbank's Monthly Report; see Deutsche Bundesbank (2018).

Contributions to the real total return of households in Germany

Percentage points, end-of-year / end-of-quarter data



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first quarter was the brief uptick in confidence at that time that it would be possible to at least partially resolve the global trade disputes. Another was the drop in capital market rates, which lowered the discount factor, pushing share prices higher.[3]

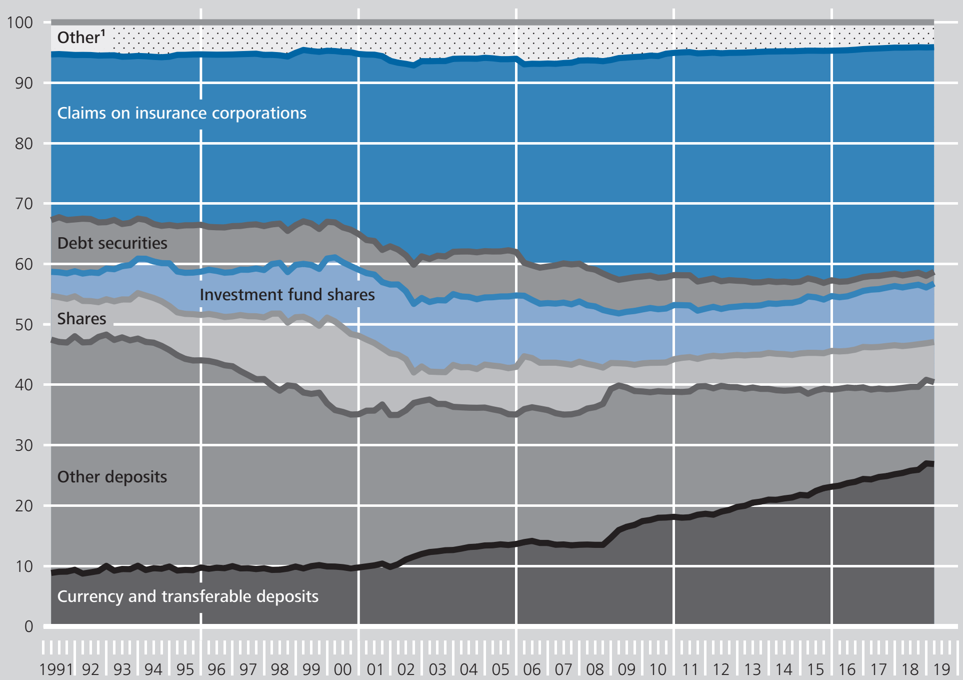
The total portfolio return (see the upper chart on p. 33) is obtained by weighting the returns on the various types of financial asset with their respective share of the total portfolio. Thus, calculated according to the composition of households' financial assets, the real total return contracted from 1.2% to roughly -2.5% over the course of 2018. It did, however, recover strongly at the beginning of 2019 on the back of buoyant securities prices, settling at a now only marginally negative level of -0.1%. Recent years have seen bank deposits, which are important on account of their volume and whose contribution has been below zero ever since the end of 2016, dampen the real total return, which was also reduced significantly by securities returns, above all in the fourth quarter of 2018. Only claims on insurance corporations continued to make a small positive contribution, increasing marginally at the beginning of 2019.

The real total return can be presented not just in terms of the different types of financial asset but also as a stylised breakdown by nominal return, portfolio and inflation component (see the lower chart on p. 33). The nominal return component approximates the extent to which the (given) nominal return path (i.e. interest payments, price effects and dividend payouts) of the different financial asset types contributes to the total return. It is also assumed here that households' stocks of each type of financial asset remain fixed over the course of the year. The portfolio component, meanwhile, is a rough proxy for moves in the nominal total return that can be attributed to changes in the composition of the total

3 Capital market developments in the first quarter of 2019 are outlined in Deutsche Bundesbank (2019a).

Structure of German households' financial assets

%, end-of-quarter data



1 Besides other accounts receivable, this also comprises other equity.
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portfolio of financial assets. Lastly, the inflation component stands for the contribution of the inflation rate (measured by the consumer price index, CPI).

Our analysis found that the nominal return component was generally the key determinant of the real total return throughout the reporting period. For the most part, its contribution has been positive over the past few years. It did, however, weaken significantly during the course of 2018, largely as a result of a muted capital market backdrop. This coincided with a persistently negative contribution by the inflation component, given that the CPI has been hovering at positive rates of between 1.3% and 2.0% since 2017. By and large, the portfolio component contributed little to the evolution of the total return. Overall, then, the aggregate drop in the nominal return component over the course of 2018, combined with the contribution of inflation, left the real total return well below zero at the end of the year. In the first quarter of 2019, by contrast, the nominal return made a significantly stronger, positive contribution, largely thanks to price gains in equity and bond markets, which almost offset the impact of the inflation component.

Changes in the composition of the financial assets portfolio can be triggered either by active portfolio shifts or by valuation effects (particularly in the case of securities). Viewed in its entirety, the composition of the financial assets portfolio has seen little change over the past years, despite fluctuations in the return (see the chart on p. 34 for further details). This corroborates the observation that the search for yield is not a major priority for households as a whole.[4]

4 More details on possible portfolio shifts by the money-holding sectors in Germany can be found in Deutsche Bundesbank (2019b).

over, unlike in the preceding quarters, the demand amongst enterprises for shorter-term loans also saw distinct growth on balance.

… due to, amongst other factors, exceptionally low interest rates …

The current developments in loans to non-financial corporations are likely to reflect a number of influencing factors: less export-oriented enterprises continued to benefit from the comparatively stable economic situation in the domestic sectors and, in particular, from consumer spending, which remained intact. Furthermore, the exceptionally low interest rates – which again fell slightly further overall in the reporting quarter – bolstered demand for bank loans amongst enterprises.

… and the rise in financing needs for fixed investment

The results of the latest BLS provide evidence of further factors influencing these developments. In the opinion of bank managers, as in the previous rounds of the survey, the upturn in demand was driven primarily by an increase in financing needs for fixed investment in the corporate lending segment. However, financing needs for refinancing, debt restructuring and renegotiation also contributed to the rise in demand once again.

Slightly restrictive lending policies for loans to enterprises

At the same time, the most recent results from the BLS indicate that banks adjusted their lending policies for loans to enterprises to be more restrictive for the second time in succession: both credit standards and credit terms and conditions were marginally tightened overall during the reporting period. In essence, the institutions justified the tightening of their lending policies on the basis of the poorer credit risk assessment as well as higher equity costs.

Persistently high demand among households, especially for housing loans …

Loans to households also made a significant contribution to the growth of German banks' lending business. The decisive factor here was housing loans, which grew roughly as briskly as they had in the preceding quarter. On balance, their annual growth rate rose again slightly to 4.8%. But consumer credit also built upon its dynamic growth from the previous year. Along-

MFI* lending and deposits in Germany

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

Item	2019 Q1	2019 Q2
Deposits of domestic non-MFIs 1		
Overnight	43.1	36.9
With an agreed maturity of		
up to 2 years	10.0	− 7.6
over 2 years	− 9.4	− 2.1
Redeemable at notice of		
up to 3 months	3.9	1.1
over 3 months	− 0.1	1.4
Lending		
to domestic general government		
Loans	− 4.1	− 1.8
Securities	− 1.8	− 3.1
to domestic enterprises and households		
Loans 2	34.5	40.8
of which: to households 3	18.2	18.5
to non-financial corporations 4	12.4	20.9
Securities	− 0.8	− 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. 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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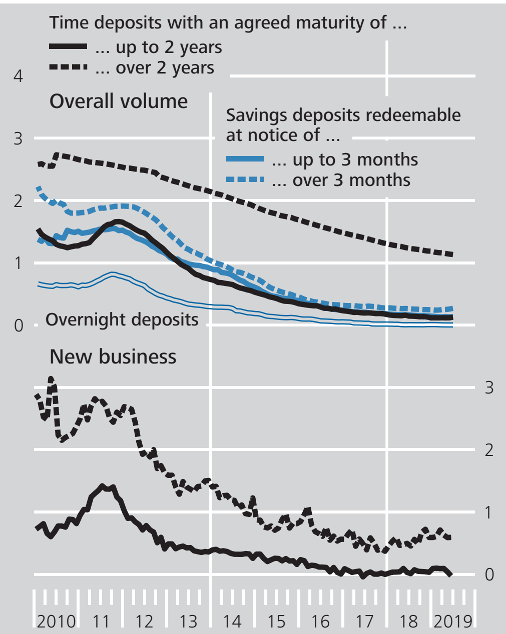
Interest rates on bank deposits in Germany*

% 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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side the persistently favourable income and asset situation in this sector, the ongoing high demand for bank loans among households was also bolstered by decidedly low financing costs.

... with uneven adjustments to lending policies overall

The banks surveyed within the context of the BLS reported that they had marginally loosened their credit standards in the area of private housing loans. However, following a period of easing credit terms and conditions that began at the start of 2017, terms and conditions were slightly tightened again for the first time. In the area of consumer credit and other lending, credit standards remained unchanged while credit terms and conditions were marginally loosened again in the reporting quarter.

Regulatory and supervisory activities, when viewed in isolation, leading to tightened credit standards ...

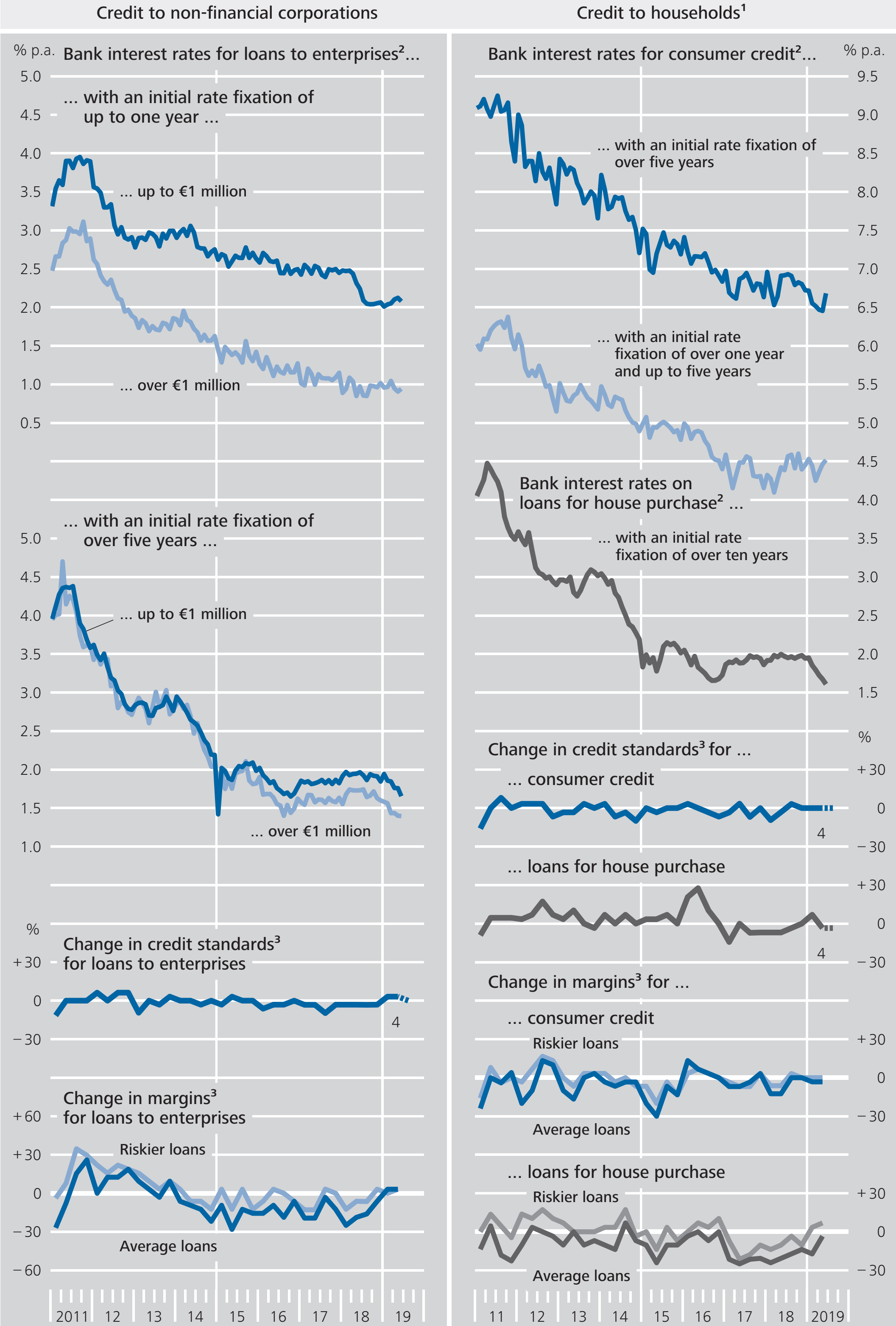
In the July survey, the German banks responding to the BLS reported that the refinancing situation had improved somewhat on the previous quarter against the background of the situation in the financial markets. In the wake of the new regulatory and supervisory activities,[5] they continued to strengthen their capital position in the first half of 2019, notably by retaining profits. At the same time, the regulatory and supervisory activities in the first half of the year, when taken in isolation, led to a tightening of credit standards, especially for housing loans. However, these measures had no effect on margins.

... but impact of NPL ratio is neutral

Based on the responses of the banks surveyed, the NPL ratio[6] had no impact on the changes to their lending policies in the first half of the year. For the next six months, however, the banks expect the NPL ratio to have a tightening effect on credit standards and terms and conditions for loans to enterprises for the first time.

5 These include the capital requirements set forth in CRR/CRD IV and the requirements resulting from the comprehensive assessment.
6 Percentage share of the stock of non-performing loans (gross) in the gross carrying amount of loans.

Banking conditions in Germany



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 Q3 2019.

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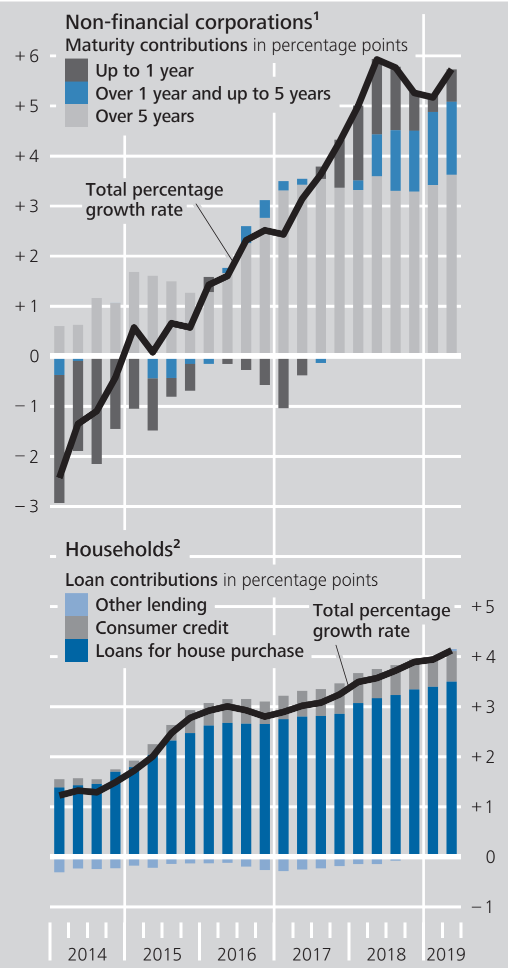
Loans* by German banks to the domestic private non-financial sector

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



* Adjusted for loan sales and securitisation. **1** Non-financial corporations and quasi-corporations. **2** Including non-profit institutions serving households.

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