# Monetary policy and banking business

## Monetary policy and money market developments

*ECB Governing Council lowers deposit rate to -0.5% and adjusts forward guidance*

At its monetary policy meeting in September 2019, the Governing Council of the ECB adopted an extensive package of measures based on its assessment of the economic and inflation outlook. It lowered the interest rate on the deposit facility by 10 basis points to -0.5%, but kept the interest rate on main refinancing operations and the rate on the marginal lending facility unchanged at 0% and 0.25%, respectively. At the same time, it adjusted its forward guidance on future key interest rates. The Governing Council now expects key interest rates to remain at their present or lower levels until it has seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2% within its projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics.

*Resumption of net purchases under APP*

Moreover, the Governing Council decided to restart net purchases under its expanded asset purchase programme (APP) at a monthly pace of €20 billion as from 1 November 2019. It expects these net purchases to run for as long as necessary to reinforce the accommodative impact of its policy rates, and to end shortly before it starts raising the key ECB interest rates. There was no change to the Governing Council's forward guidance on the reinvestment of the securities already purchased.

*Change to TLTRO III terms*

To provide further support for its accommodative monetary policy stance, the Governing Council of the ECB decided to adjust the modalities of the third series of targeted longer-term refinancing operations (TLTRO III). It extended the maturity of the individual operations from two to three years and removed the previously planned interest rate premium of 10 basis points. For banks whose eligible net lending exceeds a benchmark, the interest rate in each operation can now be as low as the average interest rate on the deposit facility prevailing over the life of the operation. The adjustments are intended to maintain favourable bank lending conditions and ensure the smooth transmission of monetary policy.

*Two-tier system for reserve remuneration*

In order to provide additional support for the bank-based transmission of monetary policy, the Governing Council decided to introduce a two-tier system for reserve remuneration. Under this system, part of banks' holdings of excess liquidity on current accounts with the Eurosystem is exempt from the negative deposit facility rate and remunerated at 0%. The volume of reserve holdings in excess of minimum reserve requirements that is exempt from the negative deposit facility rate for each institution is determined as a multiple of that institution's minimum reserve requirements. The multiplier is the same for all institutions and has initially been set at 6. The two-tier system was first applied in the seventh maintenance period of 2019, starting on 30 October 2019.[1] Both the remuneration rate of the exempt tier and the multiplier can be changed over time.

*ECB Governing Council responding to inflation developments*

The measures the ECB Governing Council adopted in September were taken in response to the continued shortfall of inflation with respect to its aim. According to the Governing Council, the incoming information indicates a more protracted weakness of the euro area economy, the persistence of prominent downside risks and muted inflationary pressures. The September Eurosystem staff projections likewise pointed to a further deterioration in the inflation outlook. At the same time, however, robust employment growth and increasing wages continued to underpin the resilience of the euro area economy.

The APP holdings recorded on the balance sheet continued to fluctuate slightly over the

1 See European Central Bank (2019a).

## Money market management and liquidity needs

The two reserve periods between 31 July 2019 and 29 October 2019 saw euro area liquidity needs stemming from autonomous factors increase slightly (see the table below). At an average of €1,434.2 billion in the September-October 2019 period, they stood €15.5 billion above the average for the June-July 2019 period, the last reserve maintenance period prior to the reporting period. The sum of the autonomous factors remained volatile and fluctuated within a range of €1,381.5 billion and €1,472.4 billion over the two periods considered. The higher volume of banknotes in circulation in the Eurosystem was the main factor behind the additional liquidity needs. This volume increased by €11.9 billion to an average of €1,252.7 billion in the September-October 2019 reserve period (see the chart on p. 24). By contrast, government deposits, which increased by €2.7 billion to an average of €298.6 billion, remained virtually unchanged on balance. The change to the combined total of net foreign assets and other factors, which are considered together owing to liquidity-neutral valuation effects, was smaller still. Here, additional liquidity absorption amounted to just €0.9 billion. Furthermore, the rise in the minimum reserve requirement also caused an increase in banks' calculated need for central bank money. The minimum reserve requirement rose by €1.8 billion to €133.2 billion during the September-October 2019 reserve period.

The total outstanding tender volume from the Eurosystem's open market operations declined further and stood at just over €670 billion on average in the September-October 2019 period, around €34 billion below the average for the June-July 2019 period (see

**Factors determining banks' liquidity***

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

| Item | 2019<br>31 July to 17 Sep. 2019 | 2019<br>18 Sep. to 29 Oct. 2019 |
|---|---|---|
| I. Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors | | |
| 1. Banknotes in circulation (increase: –) | – 10.3 | – 1.6 |
| 2. Government deposits with the Eurosystem (increase: –) | + 27.4 | – 30.1 |
| 3. Net foreign assets[1] | + 9.9 | + 38.3 |
| 4. Other factors[1] | – 29.0 | – 20.1 |
| Total | – 2.0 | – 13.5 |
| II. Monetary policy operations of the Eurosystem | | |
| 1. Open market operations | | |
| (a) Main refinancing operations | – 1.6 | – 1.0 |
| (b) Longer-term refinancing operations | – 7.6 | – 24.0 |
| (c) Other operations | – 8.0 | – 3.7 |
| 2. Standing facilities | | |
| (a) Marginal lending facility | + 0.0 | + 0.0 |
| (b) Deposit facility (increase: –) | + 15.1 | + 99.1 |
| Total | – 2.1 | + 70.4 |
| III. Change in credit institutions' current accounts (I. + II.) | – 4.2 | + 57.0 |
| IV. Change in the minimum reserve requirement (increase: –) | – 0.6 | – 1.2 |

* 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 chart on p. 25). The ECB Governing Council's interest rate decision (see p. 21) had no impact on the standard tender operations. However, this decision affected the lowest rate of interest payable on the third series of targeted longer-term refinancing operations (TLTRO III), the modalities of which were also adjusted by the ECB Governing Council (see p. 21). On 25 September 2019, the first of seven TLTRO III operations was settled; however, with 28 institutions taking up a volume of €3.4 billion, demand was only small. This was mainly attributed to credit institutions not having the chance to react to the ECB Governing Council's improvement to the conditions, as the key deadlines had already expired.

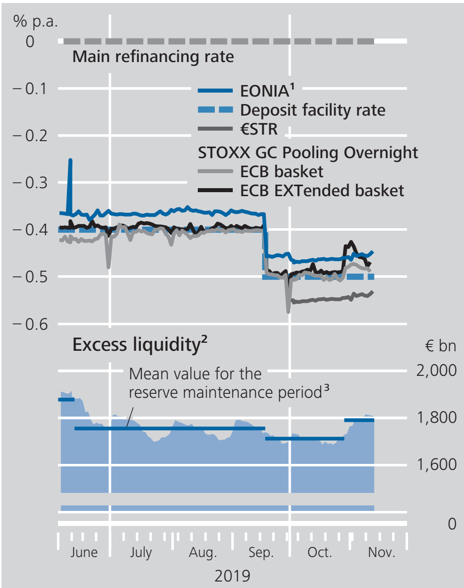
On the same day as the first TLTRO III, voluntary early repayments totalling €31.8 billion were settled on the still outstanding TLTRO II series, meaning that net liquidity of €28.4 billion was absorbed. During the reference period, there was also a decline in the central bank liquidity provided in the regular tender operations. For instance, demand for main refinancing operations decreased on average by €2.6 billion to an average of just €2.0 billion compared with the June-July 2019 reserve period. Demand for the three-month tenders also fell by €0.5 billion to €2.8 billion.

However, the Eurosystem continued to provide the bulk of central bank liquidity through its asset purchase programmes. The average balance sheet holdings of these programmes amounted to €2,609 billion during the September-October 2019 period, representing a share of almost 80% of Eurosystem central bank liquidity provided through open market operations. This represented a decline of roughly €12 billion compared with the corresponding average holdings in the June-July 2019 reserve period, which was due to amortisation adjustments, maturities and flexibility in terms of reinvestment (see the above table).

Excess liquidity decreased over the review period as a result of the lower liquidity provision and the increased liquidity needs stemming from autonomous factors. At an average of €1,712 billion in the September-October 2019 reserve period, it was €63 bil-

**Central bank interest rates, money market rates and excess liquidity**

Daily data




Sources: ECB, Eurex Repo and Bundesbank calculations. **1** From 1 October 2019, EONIA is calculated as €STR + 8.5 basis points. **2** Current account holdings minus the minimum reserve requirement plus the deposit facility. **3** The last period displayed is still ongoing.

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**Eurosystem purchase programmes**

€ billion

| Programme | Change across the two reserve periods | Balance sheet holdings as at 8 November 2019 |
|---|---|---|
| **Active programmes[1]** | | |
| PSPP | − 0.1 | 2,088.1 |
| CBPP3 | − 0.4 | 262.1 |
| CSPP | + 0.1 | 180.1 |
| ABSPP | + 0.7 | 27.5 |
| **Completed programmes** | | |
| SMP | − 5.8 | 47.8 |
| CBPP1 | − 0.5 | 2.4 |
| CBPP2 | − 0.5 | 3.0 |

**1** Changes due to maturities, reinvestments and amortisation adjustments.

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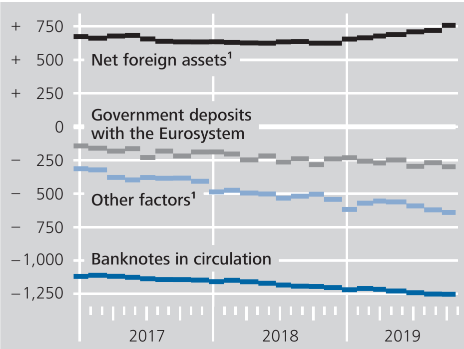
**Autonomous factors in the Eurosystem***

€ billion, mean values for the relevant reserve maintenance period




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

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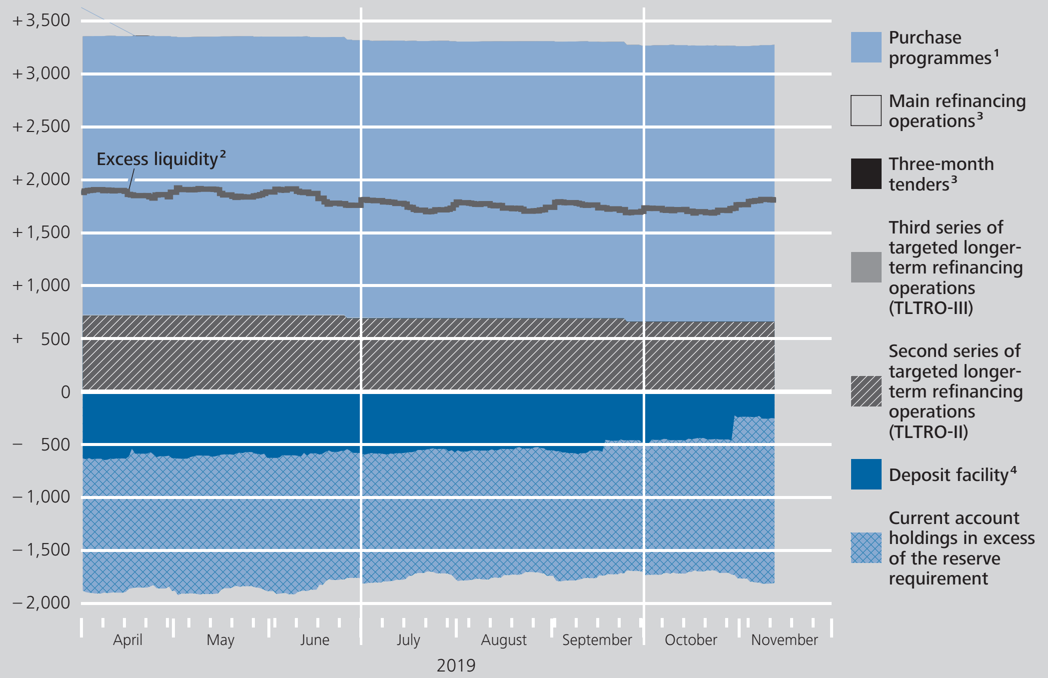
lion down on the June-July 2019 period. With the resumption of the asset purchase programmes in November 2019, increasing liquidity provision is likely to boost excess liquidity. Liquidity effects from the refinancing operations, particularly the TLTROs, remain another important determinant here. The end of the period under review saw excess liquidity holdings shift from the deposit facility to current account holdings (see the table on p. 22). This shift from one component of excess liquidity to the other is probably linked to the introduction of the two-tier system for reserve remuneration (see p. 21). As expected, the actual introduction of the system in the current reserve period reinforced this development to a considerable degree (see the chart on p. 25).

The lowering of the deposit facility rate was transmitted in full to the secured and unsecured money market rates at the beginning of the September-October 2019 reserve period. Thus, overnight rates in the euro money market continued to be geared to the rate on the deposit facility (see the chart on p. 23). The same applies to the euro short-term rate (€STR), the new reference rate for unsecured overnight money first published for 1 October 2019. The €STR stood at an average of -0.55% until the end of the September-October 2019 maintenance period. The methodology for calculating the EONIA was changed with the publication of the €STR (see the box on p. 27), but this did not affect the spread between the EONIA and the deposit facility rate. In the September-October 2019 reserve period, the EONIA stood at an average of -0.46% (previous reserve period July-September 2019: -0.36%). At €2.0 billion, EONIA turnover remained at a low level in the reporting period (up to and including 30 September). The average underlying turnover for the calculation of the €STR (from 1 to 29 October) was €32.6 billion.

On average, secured overnight money traded at the level of the deposit facility rate. On the GC Pooling platform, overnight trades in the ECB basket were executed at -0.50% on average in the September-October 2019 period and thus were 10 basis points lower than in the previous period (July-September 2019). Overnight money in the ECB EXTended basket, with its larger set of eligible securities, traded at an average of -0.49% in the September-October 2019 period. In the same period, aggregate overnight turnover across both segments was €7.2 billion on average, and therefore below the figure of €9.7 billion recorded in the previous reporting period.

## Liquidity provision and use

€ billion, daily data




Sources: ECB and Bundesbank calculations. **1** Securities markets programme (SMP), covered bond purchase programmes (CBPP1, CBPP2 and CBPP3), asset-backed securities purchase programme (ABSPP), public sector purchase programme (PSPP) and corporate sector purchase programme (CSPP). **2** Current account holdings minus the minimum reserve requirement plus the deposit facility. **3** Volume so small it is hardly visible. **4** The marginal lending facility is not shown in this chart owing to its very low volume.

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*Little change in securities holdings recognised on balance sheet*

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] On 8 November 2019, the stock of APP assets held by the Eurosystem reached a total of €2,558 billion (a breakdown of these holdings by individual asset purchase programme can be found on p. 23). However, with new purchases starting at the beginning of November, the stocks will continue to increase.

*Participation in first TLTRO III operation muted*

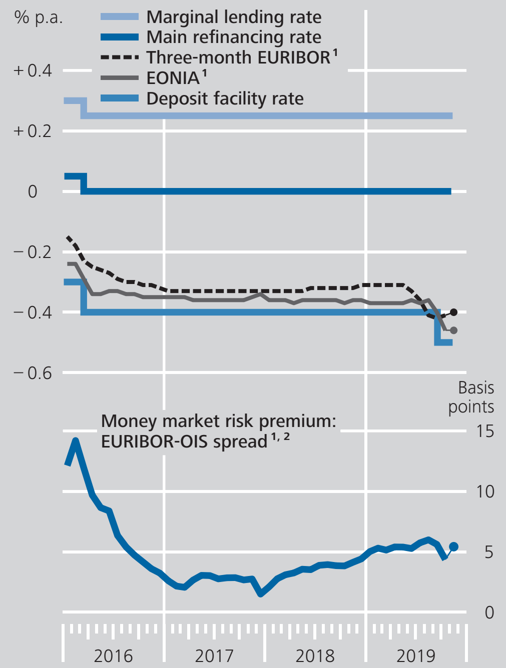
Demand for the first TLTRO III operation, settled on 25 September, was very low, with 28 banks taking up €3.4 billion in total. At the same time, €31.8 billion was paid back on the second series of targeted longer-term refinancing operations (TLTRO II) under the voluntary repayment option. This resulted in a negative net liquidity effect. Together, the TLTRO II and TLTRO III series currently have an outstanding volume of around €661 billion. Before the conditions for TLTRO III operations were adjusted in September, they were less attractive than those for the TLTRO II series. Prior to the September meeting, many banks therefore had an incentive to postpone the transition from TLTRO II to TLTRO III. These circumstances suggest that the limited demand for the first TLTRO III could be explained by the fact that the conditions for the operation were modified only shortly before it was launched. Given that the deadlines for various reporting requirements had passed, counterparties were unable to participate in the first TLTRO III operation unless they already met the requirements. As a result, demand for the second TLTRO III operation, which will be settled in December, is expected to be higher.

*Slight rise in excess liquidity*

Excess liquidity increased and, at €1,815 billion, was slightly higher than at the end of the last reporting period. Looking ahead, the resump-

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 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 11 November 2019.
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tion of net purchases under the APP from the beginning of November means that excess liquidity will probably rise more sharply again. However, its path will also depend on demand by banks for TLTRO III operations and use of the early repayment option under TLTRO II.

*Complete pass-through of decrease in deposit facility rate to short-term money market rates*

On 18 September, the deposit facility rate was lowered to -0.5%. The unsecured overnight money market rate (EONIA) mirrored the reduction almost completely and has fluctuated within a range of -0.45% and -0.47% since then. The introduction of a new methodology for calculating the EONIA (see the box on p. 27) has so far had no significant impact on the spread between the EONIA and the rate on the deposit facility.

*Significant increase in money market forward rates of late*

Having fallen further in the weeks leading up to the September meeting, money market forward rates rose significantly in the latter part of the reporting period. On 12 September itself, the day of the ECB Governing Council's monetary policy meeting, there was a marked upward shift in the yield curve. This upward movement suggests that expectations of a further decline in interest rates are tailing off. Forward rates continued to rise in the weeks after the meeting, most likely owing to market participants' dwindling expectations of falling interest rates based on what they perceived as positive news about the Brexit negotiations and the US-China trade disputes. At present, based on the forward rates, a further cut to the deposit facility rate by 10 basis points is no longer fully priced in. In the surveys carried out before the October meeting, in median terms, market participants expected the deposit facility rate to be lowered by a further 10 basis points in the first or second quarter of 2020. However, the survey results also suggest that uncertainty about a further interest rate cut has grown, as expectations, which were previously focused heavily on December 2019, now vary more widely and only a small overall majority of respondents still anticipate a further reduction.

## Monetary developments in the euro area

*Q3 2019 sees continued robust monetary growth*

The broad monetary aggregate M3 recorded strong inflows in the third quarter of 2019 as well, continuing its robust growth. Lending to the domestic private sector and inflows of funds from abroad were once again the main drivers of growth. While the expansion of loans to households continued its upward trajectory, growth in lending to non-financial corporations was dampened somewhat by the persistent economic slowdown in the euro area. According to the latest bank lending survey (BLS), banks' lending policies remained largely unchanged on balance in both corporate and retail banking during the reporting quarter.

*Households' overnight deposits still main driver of inflows to M3*

Among the components of M3, overnight deposits again accounted for by far the largest inflows in the third quarter. In addition, investors stepped up their holdings of cash, short-

## New methodology for calculating the EONIA since 2 October 2019

As of 2 October 2019, the European Money Markets Institute (EMMI) has published the unsecured overnight rate on the interbank money market (euro overnight index average, or EONIA) based on a new methodology.[1] EONIA is an important reference interest rate for the euro. It has, to date, been defined as the interest rate at which sound banks within the European Union and the European Free Trade Association (EFTA) issue unsecured loans in the interbank overnight money market denominated in euro. Up until 30 September 2019, the ECB calculated the EONIA on behalf of EMMI as the weighted average interest rate on the reported lending volumes and average interest rates of a panel comprising 28 banks at last count.

Using the old methodology, the EONIA would, after 2020, no longer have complied with the criteria set out in the EU Benchmarks Regulation. Back in September 2018, the private sector working group on euro risk-free rates[2] therefore recommended using the euro short-term rate (€STR), which is calculated and provided by the ECB based on European Money Market Statistical Reporting (MMSR), as the risk-free short-term euro reference interest rate going forward.[3]

The new €STR interest rate differs from the EONIA in key features. While the EONIA was based on the terms in interbank lending (lending concept), the €STR reflects banks' wholesale unsecured borrowing costs (borrowing concept). Hence, the €STR includes not just interbank transactions but also banks' borrowing from other non-bank financial enterprises (for instance money market funds). Consequently, as the €STR also includes a large proportion of interest rates on transactions with financial enterprises that do not have access to the Eurosystem's deposit facility, the €STR is trading slightly below the deposit facility rate in the current environment of high excess liquidity. At high levels of excess liquidity, the EONIA as calculated using the old method, meanwhile, was always several basis points above the deposit facility rate, as there is usually no incentive for banks with access to the deposit facility to issue interbank loans at a lower interest rate.

In order to ensure a smooth and gradual transition from the EONIA to the €STR, the working group in March 2019 recommended adjusting the methodology used to compute the EONIA for an interim period.[4] For a transitional period from the first publication of the €STR on 2 October 2019 onwards,[5] EMMI will calculate the EONIA daily as the €STR plus a fixed spread of 8.5 basis points. This spread was calculated as the average difference between the two concepts during a one-year reference period and was fixed and published by the ECB in May 2019.[6]

As a result of the temporary parallel publication of the EONIA in accordance with the new methodology and the €STR, EONIA can still be used for financial contracts for a limited period. The working group recommends that market participants gradually replace the EONIA with the €STR in all products and contracts and, going forward, use the €STR as the standard reference interest rate. Publication of the EONIA is to be discontinued on 3 January 2022.

1 See European Money Markets Institute (2019).
2 The working group on euro risk-free rates was set up by the ECB, the Belgian Financial Services and Markets Authority (FSMA), the European Securities and Markets Authority (ESMA) and the European Commission in 2018. Its main task is to identify and recommend alternative risk-free interest rates and transition paths. It is led by industry representatives, and the ECB provides the secretariat.
3 See European Central Bank (2018).
4 See European Central Bank (2019b).
5 The publication on day T+1 reflects transactions of the previous day, i.e. on 2 October 2019, the €STR for the reference date of 1 October 2019 was published.
6 See European Central Bank (2019c).

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

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

| Assets | Q2 2019 | Q3 2019 |
|---|---|---|
| Credit to private non-MFIs in the euro area | 126.4 | 127.7 |
| Loans | 113.8 | 102.8 |
| Loans, adjusted[1] | 135.7 | 107.3 |
| Securities | 12.6 | 24.9 |
| Credit to general government in the euro area | – 56.8 | 8.4 |
| Loans | – 1.4 | – 1.3 |
| Securities | – 55.7 | 9.7 |
| Net external assets | 108.9 | 81.4 |
| Other counterparts of M3 | 39.5 | 11.9 |

| Liabilities | Q2 2019 | Q3 2019 |
|---|---|---|
| Holdings against central government[2] | – 0.7 | 23.6 |
| Monetary aggregate M3 | 170.7 | 201.5 |
| of which components: | | |
| Currency in circulation and overnight deposits (M1) | 146.0 | 192.3 |
| Other short-term deposits (M2-M1) | 16.6 | 8.3 |
| Marketable instruments (M3-M2) | 8.1 | 1.0 |
| Longer-term financial liabilities | 47.8 | 4.4 |
| of which: | | |
| Capital and reserves | 26.1 | 24.3 |
| Other longer-term financial liabilities | 21.7 | – 19.9 |

* Adjusted for statistical changes and revaluations. 1 Adjusted for loan sales and securitisation as well as for positions arising from notional cash pooling services provided by MFIs. 2 Including central government deposits with the MFI sector and securities issued by the MFI sector held by central governments.

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term savings deposits and money market fund shares. The increase in sight deposits dominated the overall picture, however. Once again, inflows from households made the largest contribution to this increase. As before, these investors' marked preference for the shortest possible maturities probably stemmed from the narrow interest rate spreads between the different types of deposit and the uncertainty that continued to surround the economic outlook in the third quarter, too. The annual growth rate of M3 thus stood at 5.5% at the end of September.

*Loss of momentum in loans to non-financial corporations*

Among the M3 counterparts, loans granted to the domestic private sector, adjusted for sales and securitisation, recorded the largest net inflows. Their contribution to the annual growth rate of M3 rose to 3.5 percentage points at the end of the quarter. However, compared with the strong second quarter, net inflows slackened slightly. This applied mainly to loans to non-financial corporations, with the annual growth rate for this credit segment sinking to 3.7% at the end of the quarter. Net inflows at banks in Germany and France, in particular, were smaller, probably due to the gloomier economic situation. In addition to this, net outflows in Italy increased, which may have been attributable, among other things, to an improvement in Italian enterprises' liquidity situation as a result of tax relief measures, despite similarly weak growth.

*On balance, lending policies and demand for loans virtually unchanged in Q3*

According to the information provided by the banks surveyed in the BLS, neither lending policies nor the demand for loans from enterprises changed notably in the euro area on balance. Although the surveyed banks tightened their credit terms and conditions slightly overall, they simultaneously marginally eased their standards for lending to enterprises. Interest rates for loans to enterprises reached new historic lows in the third quarter. This is consistent with the view expressed by the banks surveyed in the BLS that demand for corporate loans was primarily bolstered by the low general level of interest rates. Conversely, the surveyed banks reported that their financing needs for fixed investment were now contributing only marginally to the increase in demand. Taken in isolation, declining financing needs for inventories and working capital as well as the use of alternative sources of funding pushed down demand.

*Marked rise in loans to households continues*

Adjusted for sales and securitisation, loans to households recorded substantial net inflows again in the reporting period, representing the largest contribution to growth in loans to the private sector. Although the momentum of consumer credit slowed somewhat, inflows to loans for house purchase, which are a great deal more substantial, were perceptibly higher than the previous quarter's. Once more, the euro area banks participating in the BLS attributed the observed 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. On balance, this resulted in a further slight increase in the annual growth rate of loans to households to 3.4%. Banks in France and Germany continued to post the highest net inflows, although Italy, too, recorded noteworthy net gains.

*Standards for loans for house purchase almost unchanged*

According to the BLS results, the standards for loans for house purchase in the euro area remained almost unchanged in the reporting period. By contrast, overall credit terms and conditions were tightened marginally on balance for the first time since the introduction of this separate survey category in April 2015. This was brought on, in part, by the surveyed banks widening their margins, especially on riskier loans. On the whole, however, this did not entail a significant adjustment of lending policies.

*M3 growth bolstered by demand for domestic paper among foreign investors*

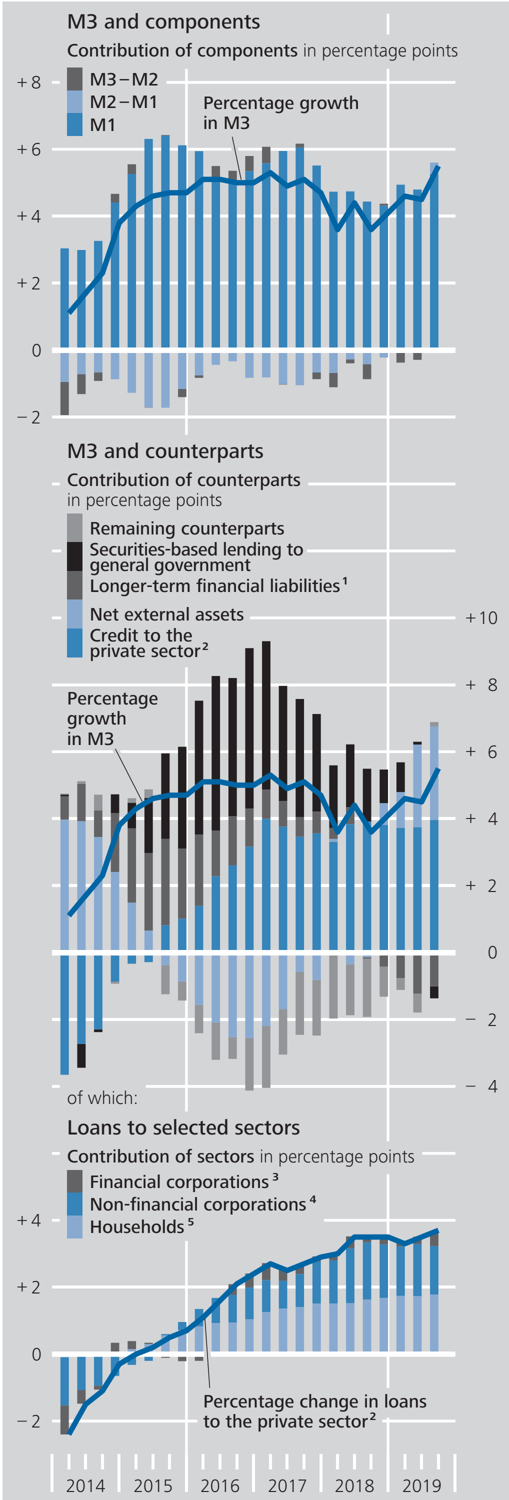
The MFI sector's net external asset position, too, continued to markedly support monetary growth in the quarter under review. Besides the euro area's sustained current account surplus, M3 growth was also attributable to the slightly positive balance of portfolio investment. Based on the non-seasonally adjusted balance of payments figures available for July and August, foreign investors made net large-scale purchases of both longer-term bonds issued by domestic general government as well as shares and mutual fund shares issued by the domestic private sector. Domestic investors exhibited an interest in foreign bonds, in particular.

*M3 also supported by securities in Q3*

On balance, the MFI sector's securities-based lending likewise had a positive impact on monetary growth in the reporting quarter. Since the discontinuation of the monthly net purchases of securities by the Eurosystem at end-2018, the development of this counterpart has pri-

**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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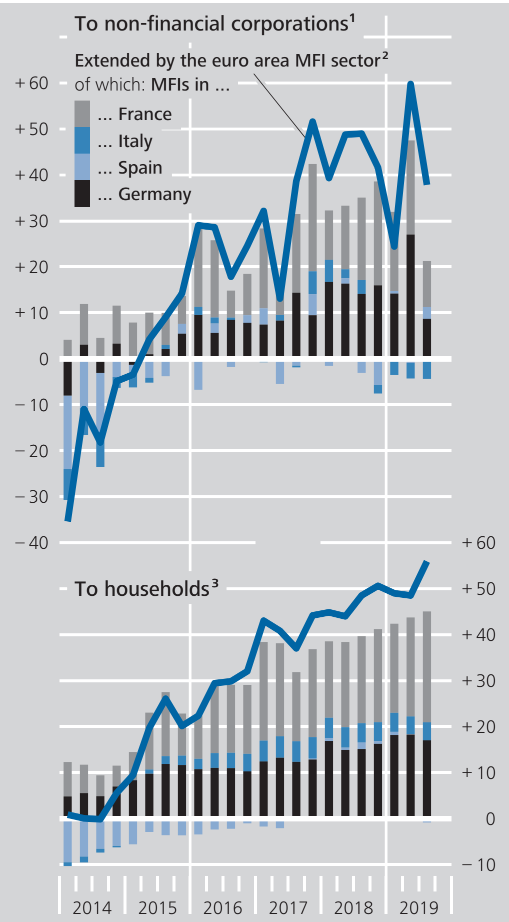
**Loans to the private non-financial sector in the euro area***

€ billion, 3-month accumulated flows, seasonally adjusted




Sources: ECB and Bundesbank calculations. * Adjusted for loan sales and securitisation. 1 Non-financial corporations and quasi-corporations. 2 Also adjusted for positions arising from notional cash pooling services provided by MFIs. 3 Including non-profit institutions serving households.
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marily reflected commercial banks' investment behaviour. Bonds and debt securities, in particular, were accumulated, whereas equity experienced only a slight rise compared with the previous quarter.

## German banks' deposit and lending business with domestic customers

German banks' deposit business with domestic customers recorded another marked increase in the reporting quarter. As in previous quarters, this solid growth was supported by strong net inflows into overnight deposits. Once again, it was households that showed a particular interest in this low-risk and highly liquid form of investment. The demand for overnight deposits was fuelled by the narrow spread on longer-term risk-free forms of investment, which dropped even further in the quarter under review. Non-financial corporations likewise further increased their holdings of overnight deposits – though not nearly by as much as households. In the corporate sector, the attractiveness of this type of deposit has tended to decrease in recent years due to the greater drop in the level of interest rates in this market segment, including into negative territory (see the box on pp. 31-32). All other types of deposit were scaled back further on balance. In particular, longer-term time deposits of insurance and pension funds recorded substantial outflows. These institutions have for some years reduced their holdings of bank deposits in favour of higher-yielding financial instruments.[3]

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

In the reporting quarter, German banks also significantly expanded their lending business with the domestic non-bank sector, albeit to a somewhat lesser extent than in the previous three-month period. The net increase – as in the preceding quarters – stemmed solely from lending business with the domestic private sector. This expansion was attributable not only to loans but also to a greater number of securitised loans being granted, especially to financial corporations. The prolonged reduction of securities-based lending to general government which had started in autumn 2015 came to a temporary halt in the quarter under review. Loans to general government, on the other hand, continued to decline, albeit on a relatively small scale.

*Significant expansion in lending business*

In the summer months, the expansion of loans to the private sector was predominantly supported by lending to households, particularly in the form of loans for house purchase. Con-

*Consistently high demand for loans for house purchase*

3 For background information, see Deutsche Bundesbank (2019), pp. 32 f.

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

The aggregate interest rate on the overnight deposits of non-financial corporations calculated in the MFI interest rate statistics[1] has been in negative territory since November 2016. By contrast, the interest rate on the overnight deposits of households has continued to be marginally positive, on average, as has the remuneration of time deposits.[2]

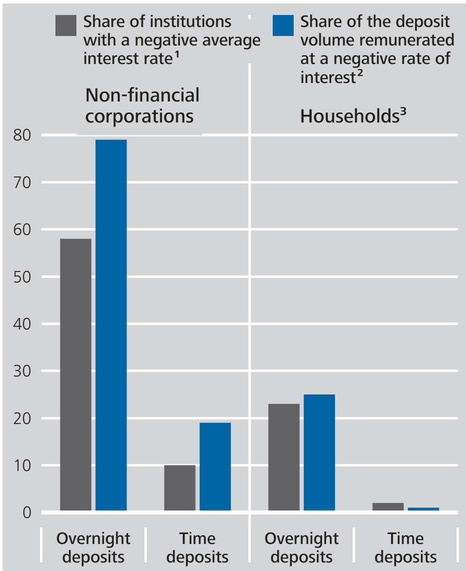
The MFI interest rate statistics calculate the level of interest rates applied to non-financial corporations and households (as well as the corresponding volumes) on a monthly basis. The data collection is designed to be a representative sample and each of the currently roughly 220 banks in the sample reports its volume-weighted average interest rates for the individual deposit items to the Bundesbank. It is therefore not possible to calculate how many banks in Germany have introduced negative deposit rates based on the data included in the MFI interest rate statistics. However, because the sample is representative, extrapolation does allow qualified conclusions to be drawn regarding the distribution in relative terms of negative interest rates across customer deposits in the German banking sector.

According to the data, 58% of reporting institutions reported a negative volume-weighted average interest rate on overnight deposits held by enterprises in September 2019. The sum of deposits at these institutions corresponds to 79% of the total volume of overnight deposits of enterprises at German banks. According to the reporting institutions, large-scale deposits, in particular, lead to negative volume-weighted average rates at bank level. Charging enterprises negative interest rates appears to be standard practice across almost all categories of banks.

In the case of households' deposits, the share of German institutions that reported a negative volume-weighted average interest rate stood at 23%, which represents a share of 25% of the total volume of overnight deposits of households at German banks. Negative interest rates are charged especially by big banks, savings banks and cooperative banks.

**Bank deposits remunerated at a negative rate of interest in Germany**

%, month-end data: September 2019




1 Share of reporting institutions with a volume-weighted negative average interest rate in the full MFI interest rate statistics sample comprising roughly 220 institutions. 2 Share of the extrapolated deposit volume of institutions with a negative average interest rate in the total deposit volume of banks in Germany. 3 Including non-profit institutions serving households.

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1 See Deutsche Bundesbank (2017), pp. 93 ff.
2 While negative effective interest rates first appeared in the MFI interest rate statistics in 2016, the negative real remuneration of households' bank deposits is not a new phenomenon. Over the past few decades, there have repeatedly been spells of negative real interest rates. The real deposit rate is an interest rate adjusted for inflation which reflects the increase in purchasing power resulting from the interest paid on the deposit. See Deutsche Bundesbank (2017), pp. 101 ff.

In the case of time deposit holdings, these figures were significantly lower. On average, only around 10% of institutions reported negative interest rates on time deposits for enterprises and around 2% of institutions reported negative interest rates on time deposits for households. This represents volume shares of 19% and 1%, respectively.

Empirical studies on interest rate pass-through show that, in Germany, the interest rates on time deposits at the aggregate level are usually based on developments in short-term market interest rates (12-month EURIBOR), however, they exhibit a higher level.[3] The 12-month EURIBOR has been in negative territory since February 2016 and sank to -0.34% at the end of September 2019. In the long term, just over 73% of changes in the market rate are passed through to the interest rate on the time deposits held by households and non-financial corporations. In the case of overnight deposits at the aggregate level, there is a long-term relationship with a market interest rate (EONIA) only for the deposits of non-financial corporations.[4] This may indicate that developments in this deposit rate for households have decoupled from developments in market interest rates, particularly when the latter are negative, and, for the most part, a zero lower bound for deposit rates still applies de facto.

3 The interest rate for households' time deposits has been, on average, roughly 37 basis points above the level of the 12-month EURIBOR since 2003; for time deposits held by non-financial corporations, the spread was only around 3 basis points.
4 The interest rate on the overnight deposits of non-financial corporations has, on average, stood at around 15 basis points above the EONIA since 2003. The long-term pass-through is roughly 55%.

sumer credit again recorded substantial inflows as well, although its growth slowed down somewhat compared with the strong previous quarter. According to the banks surveyed as part of the BLS, demand in both credit segments – as in the previous quarters – was supported, above all, by the low general level of interest rates. Interest rates on loans for house purchase with long rate fixation periods, for example, dropped to a new all-time low of 1.2% at the end of the third quarter. In addition, households maintained a positive outlook on the housing market and house price developments. On balance, the annual growth rate of loans to households continued to rise slightly to 4.2% as at the end of the quarter, constituting a year-on-year increase of ½ percentage point.

*Retail lending policies largely unchanged*

The latest BLS results indicate that banks' lending policies for retail customers remained broadly unchanged in the reporting quarter. In this context, the surveyed banks reported having left their credit standards unchanged. However, they tightened the terms and conditions for loans for house purchase on aggregate for the second time in a row, after having almost continuously eased them since early 2017. This primarily had a bearing on margins, which were widened again – also for average-risk loans – for the first time since 2014.

*Only slight increase in loans to non-financial corporations*

Loans to non-financial corporations grew only slightly in the quarter under review. On the one hand, this was due to the fact that a part of the strong build-up of short-term loans seen in the preceding quarter was redeemed in the third quarter. On the other hand, longer-term loans, which had posted dynamic growth in the first half of the year, likewise recorded substantially lower net inflows in the summer months. One reason for this could be a weakening of investment activity, which had already been observed in the second quarter and may have continued into the third. On balance, the annual growth rate of loans to domestic enterprises fell distinctly from 5.7% at end-June to 4.9% at end-September.

*Demand chiefly supported by low interest rates*

Demand for loans to enterprises was propped up by the prolonged downward trend in interest rates in this credit segment, notably for longer lock-in periods. This is consistent with the BLS banks reporting that the low general level of interest rates fuelled credit demand even more in the quarter under review than one quarter earlier, according to their assessment. By contrast, demand was once again dampened by the decrease in financing needs for inventories and working capital and by companies tapping alternative sources of funding; however, the impact of the latter has been weakening discernibly since autumn 2018.

*Corporate lending policies broadly unchanged*

Following a period of easing, which lasted from the beginning of 2017 to end-2018, the surveyed banks – according to the BLS – in the reporting quarter marginally tightened their lending policies in the corporate loan segment for the third consecutive time. The banks justified the adjustment of their standards, above all, with a more negative risk assessment of industry and firm-specific factors. In addition, they reported a deterioration in how they perceived the economic situation and the economic outlook, as well as higher capital costs. Taken as a whole, credit terms and conditions did not change, according to the surveyed banks. Nonetheless, the margins on riskier loans, in particular, but also on average exposures, were widened further.

*Virtually no change in German banks' funding environment*

In reply to the ad hoc questions in the October BLS, German banks reported that their funding conditions had remained virtually unchanged compared with the previous quarter. However, banks reported that, viewed in isolation, the Eurosystem's expanded APP had slightly improved their liquidity position over the past six months, whereas it did not improve their market financing terms during this period. Furthermore, the programme weighed on banks' profit situation more heavily than during the last survey, although net purchases had been

## MFI* lending and deposits in Germany

€ billion, 3-month accumulated flows, seasonally adjusted

| Item | 2019 Q2 | 2019 Q3 |
|---|---|---|
| Deposits of domestic non-MFIs1 | | |
| Overnight | 36.9 | 40.3 |
| With an agreed maturity of | | |
| up to 2 years | − 7.7 | − 0.6 |
| over 2 years | − 2.1 | − 8.1 |
| Redeemable at notice of | | |
| up to 3 months | 1.1 | − 1.5 |
| over 3 months | 1.1 | − 1.1 |
| Lending | | |
| to domestic general government | | |
| Loans | − 1.7 | − 2.6 |
| Securities | − 2.7 | 0.6 |
| to domestic enterprises and households | | |
| Loans2 | 40.6 | 24.4 |
| of which: to households3 | 18.5 | 16.9 |
| to non-financial corporations4 | 20.7 | 3.8 |
| Securities | − 0.2 | 7.1 |

* As well as banks (including building and loan associations, but excluding the Bundesbank), monetary financial institutions (MFIs) here also include money market funds. 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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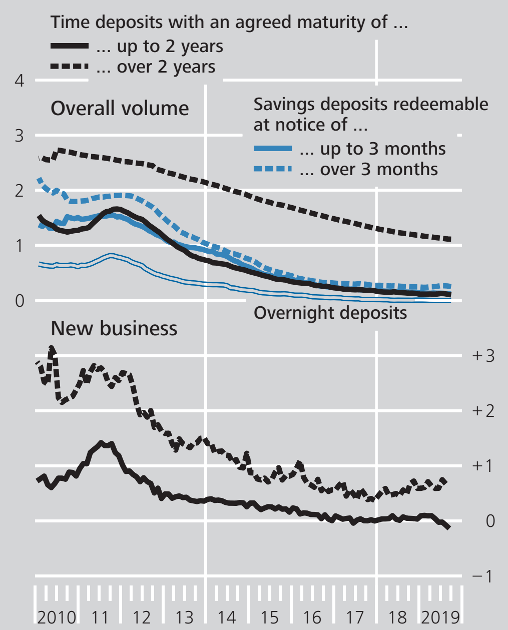
## Interest rates on bank deposits in Germany*

% 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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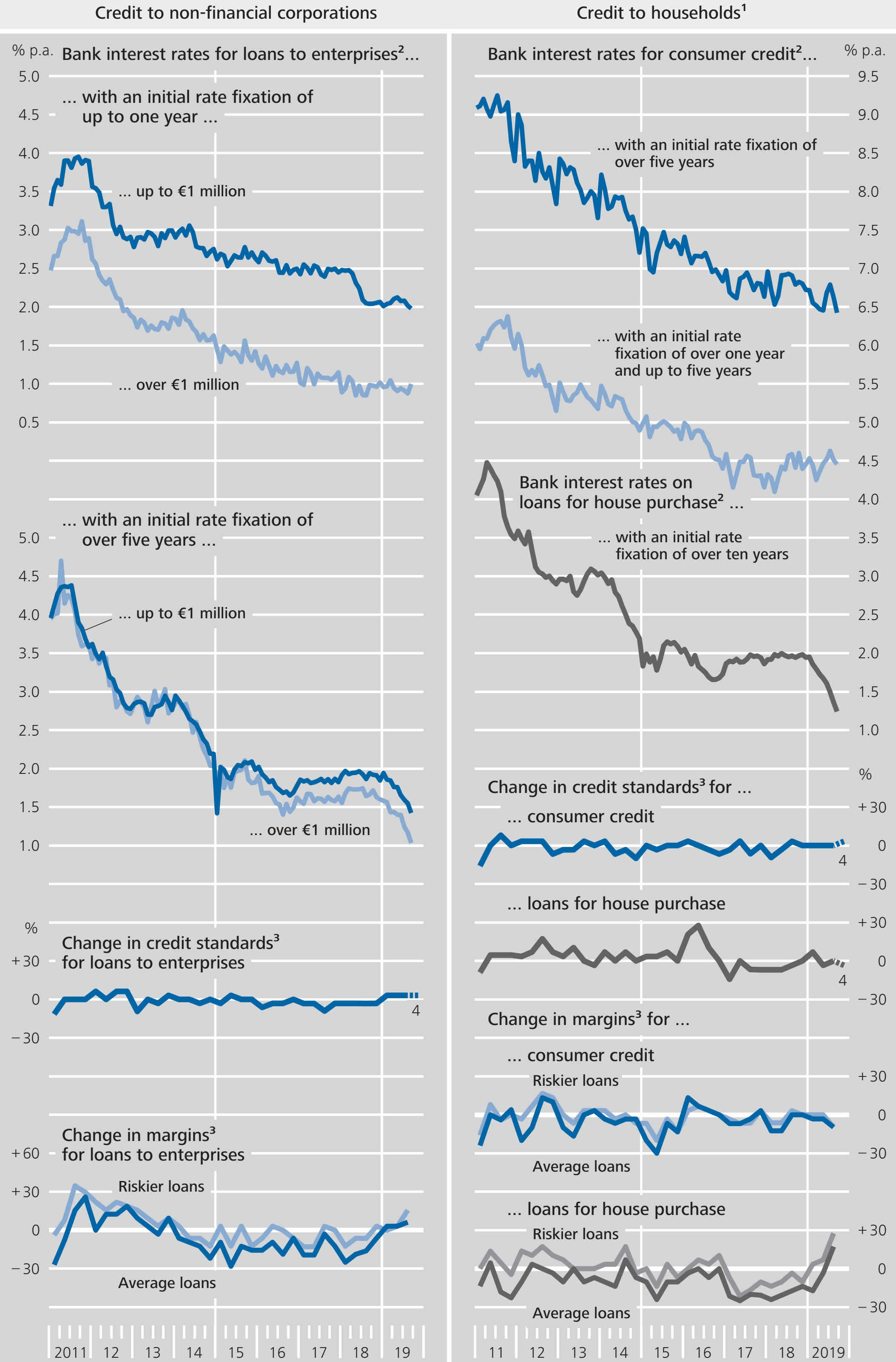
## Banking conditions in Germany




**1** Including non-profit institutions serving households. **2** New business. According to the harmonised MFI interest rate statistics. **3** According to the Bank Lending Survey; for credit standards: difference between the number of respondents reporting "tightened considerably" and "tightened somewhat" and the number of respondents reporting "eased somewhat" and "eased considerably" as a percentage of the responses given; for margins: difference between the number of respondents reporting "widened considerably" and "widened somewhat" and the number of respondents reporting "narrowed somewhat" and "narrowed considerably" as a percentage of the responses given. **4** Expectations for Q4 2019.

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discontinued at the start of the year. Just as in the previous survey round, the APP had no meaningful impact on lending policies and the credit volume in the two preceding quarters.

*German banks' profitability strained by APP and …*

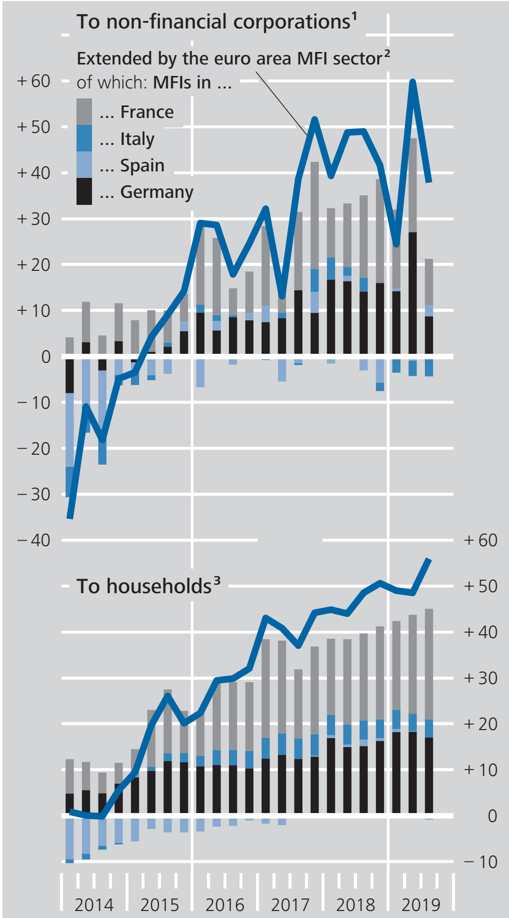
In view of the ECB Governing Council's decision in September to resume net purchases from November 2019 onwards, the credit institutions were apprehensive of heavier strains on their profitability over the next six months. At the same time, they deem it likely that the APP will lead to an increase in credit volume in business with households. They do not expect their lending policies to be significantly affected, however.

*… negative deposit facility rate*

The negative deposit facility rate was again a key factor in banks' net interest income shrinking over the past six months due to its dampening impact on lending rates, amongst other reasons. Simultaneously, according to the banks' assessment, the negative deposit rate led to an increase in the volume of loans to both enterprises and households during this period, when viewed in isolation. Overall, the banks expect the negative effect of the deposit facility rate on net interest income to ebb off over the next six months as a result of the relief the two-tier system for remunerating reserve holdings is expected to provide, as mentioned by some of the banks. At this stage, notable positive effects on credit volume are only anticipated for loans to enterprises.

**Loans to the private non-financial sector in the euro area***

€ billion, 3-month accumulated flows, seasonally adjusted




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