Monetary policy and banking business

Monetary policy and money market developments

ECB Governing Council leaves monetary policy stance unchanged

Based on its assessment of the economic and inflation outlook, the ECB Governing Council kept the key interest rates unchanged at its monetary policy meetings in December 2019 and January 2020. Therefore, the main refinancing rate remains at 0.0%, while the rate of the marginal lending facility stands at 0.25% and the deposit facility rate at -0.5%. The ECB Governing Council now expects the 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. This convergence should also be consistently reflected in underlying inflation dynamics. In November 2019, the Eurosystem resumed net purchases under its asset purchase programme (APP) at a monthly volume of €20 billion. The Governing Council expects these net purchases to run for as long as necessary to reinforce the accommodative impact of the policy rates, and to end shortly before the key ECB interest rates start to be raised.

Risks to euro area growth outlook lower

In the Governing Council's view, the incoming data in January were in line with the baseline scenario of ongoing, but moderate, growth of the euro area economy. According to this assessment, the weakness in the manufacturing sector still remains a drag on euro area growth momentum; however, ongoing, albeit decelerating, employment growth and increasing wages are supporting the resilience of the economy. Risks to the growth outlook are still tilted to the downside as a result of external factors, but have moderated somewhat. This assessment is largely due to the partial easing of uncertainty surrounding global trade. While inflation developments remain subdued, the Governing Council sees some signs of a slight increase in underlying inflation in line with expectations.

ECB Governing Council decides to review its monetary policy strategy

At the monetary policy meeting in January, the Governing Council also decided to launch a review of the Eurosystem's monetary policy strategy. The review will particularly focus on the quantitative formulation of price stability, the monetary policy toolkit, economic and monetary analyses and communication practices. As part of the review, the Governing Council will also review the effectiveness and the potential side effects of the monetary policy toolkit developed over the past decade. The review will also take into account how other considerations, such as financial stability, employment and environmental sustainability, could be relevant in pursuing the ECB's mandate. The Eurosystem wants to involve all stakeholders to ensure the review is based on thorough analysis and open minds. As things currently stand, the process is expected to be concluded by the end of the year.

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 12 February 2020.
Deutsche Bundesbank

Money market management and liquidity needs

The two reserve periods between 30 October 2019 and 28 January 2020 saw euro area liquidity needs stemming from autonomous factors decrease by €54.4 billion to €1,379.8 billion (see the table below),[1] whereas they had increased in the same periods of the two preceding years. Around the end of the year, the autonomous factors fluctuated less than usual and were at a lower level overall. A significant factor behind the declining liquidity needs was the decrease in government deposits with the Eurosystem by a total of €86.8 billion. Banknotes in circulation moved in the opposite direction, recording a seasonal increase of €29.5 billion to €1,269.2 billion (see the chart on p. 24). Liquidity needs from the combined total of net foreign assets and other factors, which are considered together owing to liquidity-neutral valuation effects, rose by a moderate €2.9 billion compared with the September-October 2019 reserve period. The minimum reserve requirement stood at €134.5 billion in the December 2019-January 2020 reserve period, representing an overall increase of €1.2 billion.

As of the beginning of the reporting period on 30 October 2019, the Eurosystem introduced a two-tier system for remunerating excess reserve holdings which exempts part of the excess liquidity holdings from negative remuneration at the rate applicable on the deposit facility. Euro area banks subject

1 Average of the eighth 2019 reserve maintenance period (December 2019-January 2020) as compared to the average of the sixth reserve maintenance period (September-October 2019), which was reported on in the November 2019 issue of the Monthly Report.

Factors determining banks' liquidity*

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

Item	2019/2020 30 October to 17 December	2019/2020 18 December to 28 January
I. Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors		
1. Banknotes in circulation (increase: –)	– 10.2	– 19.3
2. Government deposits with the Eurosystem (increase: –)	+ 72.0	+ 14.8
3. Net foreign assets[1]	+ 14.8	– 4.7
4. Other factors[1]	– 6.8	– 6.2
Total	+ 69.8	– 15.4
II. Monetary policy operations of the Eurosystem		
1. Open market operations		
a) Main refinancing operations	– 0.2	+ 1.1
b) Longer-term refinancing operations	– 4.8	– 47.6
c) Other operations	+ 10.1	+ 20.3
2. Standing facilities		
a) Marginal lending facility	+ 0.0	+ 0.0
b) Deposit facility (increase: –)	+ 198.7	+ 3.3
Total	+ 203.8	– 22.9
III. Change in credit institutions' current accounts (I. + II.)	+ 273.6	– 38.4
IV. Change in the minimum reserve requirement (increase: –)	– 0.9	– 0.3

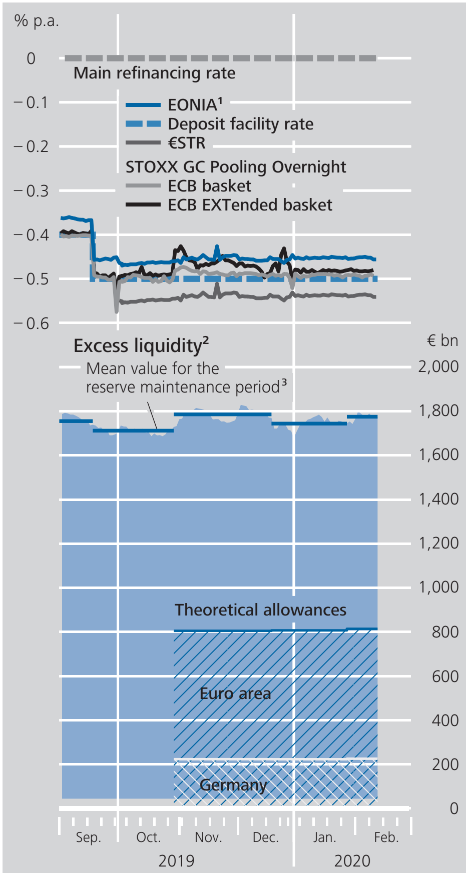
* For longer-term trends and the Bundesbank's contribution, see pp. 14• and 15• of the Statistical Section of this Monthly Report. **1** Including end-of-quarter liquidity-neutral valuation adjustments.
Deutsche Bundesbank

to minimum reserve requirements are each given an allowance of six times their minimum reserve requirements (totalling €804.8 billion in the seventh maintenance period of 2019); banks used a volume-weighted average of 95.4% of this allowance (see the adjacent chart). German institutions used an average of 93.6% of their allowances, totalling €223.1 billion. In the subsequent year-end period, the allowances in the Eurosystem rose slightly by €2 billion to €806.9 billion (96.3% utilisation) and in Germany declined slightly by €0.3 billion to €222.8 billion (94.6% utilisation). Since the allowances are applied only to excess reserves, credit institutions shifted excess liquidity from the deposit facility to their current accounts when the system was introduced. Another effect of the introduction of the two-tier system for remunerating excess reserve holdings was that excess liquidity was distributed more widely across the banking systems of the euro area Member States. The banking systems in Italy, Spain, Ireland and Greece, for example, now account for a higher share of the excess liquidity held in the euro area as a whole.

There was a significant change in the outstanding tender volume during the reporting period. In the December 2019-January 2020 reserve period, it averaged around €619 billion, putting it roughly €52 billion below the corresponding figure for the September-October 2019 period (see the chart on p. 25). The decrease stemmed mainly from voluntary early repayments of the second series of targeted longer-term refinancing operations (TLTRO-II) relative to demand for the second TLTRO-III operation, which resulted in a net TLTRO repayment of €49.1 billion (total volume still outstanding: €612 billion). Demand for standard refinancing operations remained at a very low level. For example, the average volumes of the main refinancing operation and the three-month tenders were €2.9 billion and €4.3 billion, respectively, in the period from

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 7 February 2020
Active programmes[1]		
PSPP	+ 28.8	2,118.7
CBPP3	+ 7.4	268.4
CSPP	+ 11.1	190.6
ABSPP	+ 1.5	28.4
Completed programmes		
SMP	− 1.3	44.8
CBPP1	− 0.8	1.6
CBPP2	− 0.1	2.9

1 Changes due to net purchases, maturities, reinvestments and amortisation adjustments.

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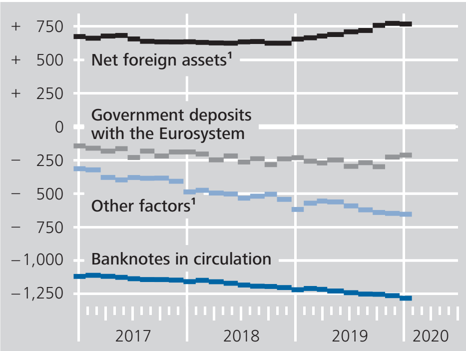
Autonomous factors in the Eurosystem*

€ 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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December 2019 to January 2020 (same period of the previous year: €7.9 billion and €5.0 billion).

The bulk of the central bank liquidity continued to be provided by the Eurosystem through the monetary policy asset purchase programmes, which accounted for around 80% of the total liquidity made available through open market operations in the reporting period. The average balance sheet holdings of all purchase programmes in the December 2019-January 2020 period stood at €2,639 billion, representing an increase of around €30 billion compared to the corresponding average holdings in the September-October 2019 reserve period; compared with the same period of the previous year, however, this constituted a decrease of €14 billion (see the table on p. 23). One reason why the increase was not larger even though monthly net purchases recommenced in November 2019 was because securities purchased under the terminated programmes matured.

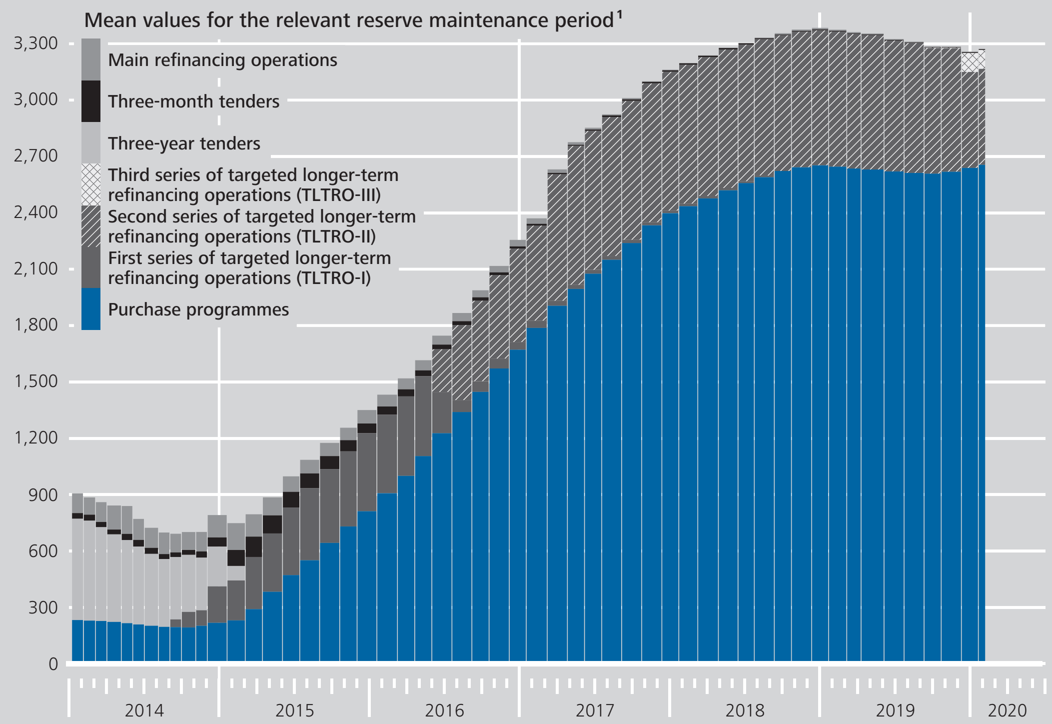
On balance, excess liquidity came to an average of €1,744 billion in the December 2019-January 2020 period (+€32 billion compared with the September-October 2019 period). However, compared with the corresponding period of the previous year, excess liquidity dropped by €101 billion, mainly due to early repayments of outstanding TLTRO-II amounts.

In view of the oversupply of liquidity, overnight rates continued to be geared to the rate on the deposit facility of -0.50% (see the chart on p. 23), with the new, unsecured euro short-term rate (€STR) staying below the secured overnight rates of the GC Pooling platform at all times. Another determinant of money market rates was the introduction of the two-tier system for remunerating excess reserve holdings. This led to increases in the overnight rates, because banks with unused allowances were willing to pay higher rates for the liquidity they obtained. The rise in the €STR was small and only discernible in the subsequent days (from mostly -0.55% to -0.54%). A clearer effect was observed for secured overnight money with an expanded set of eligible securities traded on the GC Pooling platform (ECB EXTended basket). These rates temporarily rose by 5 basis points to -0.44% when the new system entered into effect on 30 October 2019. For secured overnight money with a smaller set of eligible securities (ECB basket), there was an increase of 2 basis points to -0.48%. While both rates went back down, they remained at a slightly higher level than in the periods prior to the introduction of the two-tier system.

The money market recorded only minor year-end effects overall in 2019. This was evidenced by much smaller fluctuations in the secured market than in previous years, such as for overnight money in the GC Pooling ECB basket. The rate was determined to be -0.52% on the last day of the year (2 basis points lower than the previous day; in the previous year, however, it had been 6 basis points lower). In the unsecured market, the €STR rose by 1 basis point to -0.53%, with lower turnover volumes of €18 billion (roughly €30 billion were normal).

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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Increase in securities holdings recorded on balance sheet

In the reporting period, the APP holdings recorded on the balance sheet rose as a result of the resumption of net purchases. On 7 February 2020, the stock of APP assets held by the Eurosystem reached a total of €2,606 billion (a breakdown of these holdings by individual asset purchase programme can be found on pp. 22 ff.). The holdings continue to also be influenced by the smoothing over time of reinvestments in line with the technical parameters agreed upon in December 2018 and by the use of amortised cost accounting.[1]

Considerably higher demand in second TLTRO-III

On 18 December 2019, the second operation of the third series of targeted longer-term refinancing operations (TLTRO-III) was settled. Demand was significantly greater than in the first operation, totalling €97.7 billion, but was nonetheless below the expectations reported in prior surveys. As the monetary policy counterparties voluntarily repaid funds from the second series of targeted longer-term refinancing operations (TLTRO-II) at the same time to the tune of €146.8 billion, this resulted in a negative net liquidity effect. Together, the TLTRO-II and TLTRO-III series currently have an outstanding volume of around €612 billion.

Excess liquidity slightly lower than in November 2019 after fluctuations during year-end period

Following the seasonal fluctuations of autonomous factors in the year-end period, the volume of excess liquidity stood at €1,790 billion as this report went to press and was therefore slightly lower than in November 2019. In particular, the slightly lower liquidity provision from monetary policy operations (TLTROs and APP) had an impact here.

Only minor year-end effects on short-term money market rates

Short-term money market rates remained virtually unchanged overall. The unsecured overnight rate EONIA rose by approximately just 1 basis point by the end of the year and remained within a narrow range of between -0.46% and

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

-0.44% over the entire period under review. Although secured rates in the euro area, including STOXX GC Pooling, showed marginally stronger year-end effects than the unsecured rate EONIA, these effects were significantly weaker than in previous years.

Two-tier system with minor impact overall on money market rates

On 30 October 2019, the two-tier system for reserve remuneration came into effect. Thus far, it has had only a minor effect on the euro short-term rate (€STR),[2] which rose by approximately just 1 basis point. The underlying turnover for the calculation of the €STR has also shown virtually no response to the introduction of the two-tier system. German money market statistics indicate a more nuanced picture for the interbank loans recorded in Germany.[3] The introduction of the two-tier system saw a strong increase in the average unsecured overnight lending by reporting institutions in Germany to credit institutions domiciled in the euro area (including Germany). This suggests that it was attractive for German institutions that hold more excess liquidity than their exempt tier to lend liquidity to other credit institutions. In this context, borrowing liquidity at interest rates above the Eurosystem's deposit facility rate can be profitable for the receiving institutions if they would not otherwise exhaust their exempt tier.

Expectations of interest rate cuts temporarily priced out

In December 2019 and also initially in January 2020, money market forward rates continued to rise, particularly at the short end. While the communication following the monetary policy meeting resulted in only minor immediate responses in the forward curve, a further improvement in market participants' assessment of economic developments led to continued increases in forward rates. In particular, the signing of the "phase one" trade deal between the United States and China and further clarity in the Brexit process have probably reduced the downside risks to activity from the perspective of market participants. After previously being inverted, the forward curve became temporarily completely un-inverted. This suggests that the majority of market participants no longer expected any further policy rate cuts, which was also confirmed in the monetary policy surveys before the ECB Government Council meetings in December 2019 and January 2020. However, at the current end, the forward rates have fallen again, partly owing to uncertainty surrounding the potential impact of the coronavirus.

Monetary developments in the euro area

At 5%, monetary growth robust in Q4 2019

At an annual rate of 5%, growth in the broad monetary aggregate M3 remained robust in the fourth quarter of 2019. However, the net inflows were less dynamic than in the preceding quarters, primarily owing to reduced inflows of funds from abroad. Once again, monetary growth was largely supported by lending to the domestic private sector. However, developments in this area were mixed. While the expansion of loans to households continued on its upward trajectory, subdued euro area economic growth dampened non-financial corporations' demand somewhat. Aside from this, financing conditions on the capital markets improved in 2019, meaning that an attractive alternative to bank loans was available to enterprises.

Households' overnight deposits remain main drivers of M3, albeit with somewhat less momentum

Net inflows to overnight deposits were once again the main drivers of M3. Although the momentum slowed somewhat compared with the first three quarters of 2019, inflows remained high. The investment behaviour of households remained the main reason for the ongoing build-up of overnight deposits. Households also preferred short-term bank deposits in the period under review, which may have been due to the persistently narrow interest rate spreads of the different types of deposit

2 Since 2 October 2019, the €STR has also formed the basis for calculating EONIA. See also Deutsche Bundesbank (2019a).
3 By contrast, the €STR reflects not only interbank transactions but also banks' unsecured overnight borrowing from other non-bank financial enterprises.

and also households' continuing high risk aversion. Thus, short-term savings deposits – heavily influenced by households – recorded noticeable inflows. By contrast, households and enterprises substantially scaled back their short-term time deposits in the reporting quarter. Owing to another distinct drop in the interest rate in recent months, the attractiveness of this form of investment has continued to fall.

Substantial net inflows for loans to households continue to rise

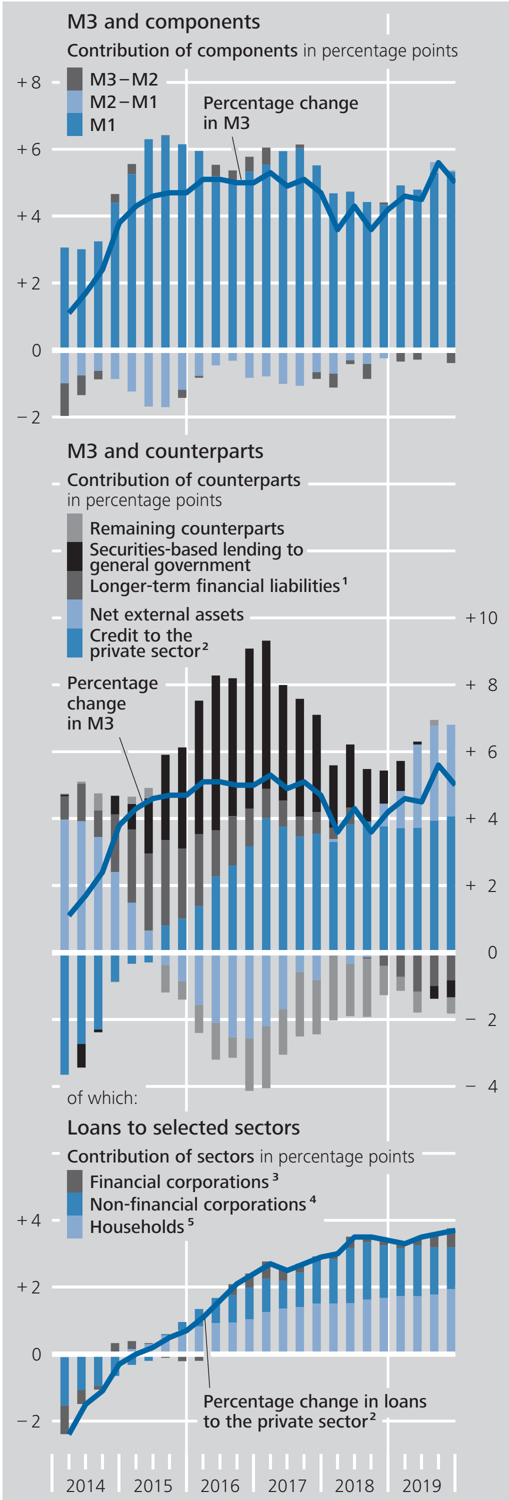
Looking at the M3 counterparts, the most significant net inflows in the fourth quarter of 2019 were again of loans to the domestic private sector adjusted for loan sales and securitisation. At the end of December 2019, the total contribution of these loans amounted to just over two-thirds of the annual growth rate of M3. In particular, net inflows to loans to households accelerated again markedly after having already increased distinctly in the previous quarter. Thus, their annual growth rate rose to 3.7% at the end of the year. Loans for house purchase were the main driver here, but consumer loans also remained in high demand given rather robust consumption activity in the euro area. The increase in the dynamism of lending to households was broadly distributed among all Member States. In particular, the fourth quarter of 2019 saw an acceleration in net inflows at banks in Germany and also in some smaller countries. In France, growth dynamics in this credit segment already started to increase in mid-2019.

Lending policies for housing virtually unchanged

From the perspective of the banks surveyed in the Bank Lending Survey (BLS), demand for loans to households for house purchase continued to accelerate in the euro area. Bank managers attributed the further rise in demand to the low general level of interest rates, in particular, as well as the positive outlook for the housing market and house price developments. In addition, the contribution of consumer confidence to the rise in demand was greater than in recent quarters. Banks' lending policies did not stand in the way of the expansion of lending in this segment. For the banks participating in the survey, the standards for loans for house

Monetary aggregates and counterparts in the euro area

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



Source: ECB. **1** Denoted with a negative sign because, per se, an increase curbs M3 growth. **2** Adjusted for loan sales and securitisation as well as for positions arising from notional cash pooling services provided by MFIs. **3** Non-monetary financial corporations and quasi-corporations. **4** Non-financial corporations and quasi-corporations. **5** Including non-profit institutions serving households.

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

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

Assets	Q3 2019	Q4 2019	Liabilities	Q3 2019	Q4 2019
Credit to private non-MFIs in the euro area	129.1	90.1	Holdings against central government[2]	14.6	– 37.5
Loans	102.3	76.6	Monetary aggregate M3	210.2	107.0
Loans, adjusted[1]	105.2	104.2	of which components:		
Securities	26.8	13.4	Currency in circulation and overnight deposits (M1)	195.8	138.6
Credit to general government in the euro area	– 2.1	– 5.1	Other short-term deposits (M2-M1)	10.2	– 27.8
Loans	– 0.9	– 15.4	Marketable instruments (M3-M2)	4.2	– 3.8
Securities	– 1.1	10.2	Longer-term financial liabilities	13.0	0.3
			of which:		
Net external assets	84.0	30.1	Capital and reserves	24.0	24.5
Other counterparts of M3	26.8	– 45.1	Other longer-term financial liabilities	– 11.1	– 24.1

* 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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purchase remained almost unchanged in the fourth quarter of 2019 for the third time in succession. Although the reduced risk tolerance of the surveyed banks had a restrictive effect when viewed in isolation, its influence on the standards was neutralised by the countervailing effect of the intense competition between lenders and the improved assessment of the credit risk, not least owing to the good outlook for the housing market. Alongside credit standards, the bank managers surveyed also perceived credit terms and conditions – which were tightened marginally in the preceding quarter – to be virtually unchanged overall.

Loss of momentum in lending to non-financial corporations

Unlike lending to households, loans to non-financial corporations grew only moderately in the fourth quarter. The gradual decline in the annual growth rate thus continued; at the end of December, it stood at 3.2%, after 4.0% one year earlier. At country level, lending development remained heterogeneous. Overall, however, the slowdown appears to be broad-based: for instance, as in the third quarter, net inflows recorded by banks in Germany and France – which are significant for the aggregate – fell clearly short of the high inflows recorded in the previous quarters. Banks in Italy saw the net outflows which have been observed since autumn 2018 continue. The loss of momentum in credit growth in the euro area is likely to be mainly demand-driven. In Italy, in particular, the weak underlying cyclical trend dampened enterprises' demand for additional funding.[4] However, other euro area countries, too, have experienced a perceptible weakening of economic growth since the beginning of 2018. In addition, non-financial corporations began to increase their uptake of funds in the capital market again in 2019. A contributing factor was that the overall cost of financing based on fixed-income securities became more favourable compared with loans-based financing.

Decline in non-financial corporations' demand for credit; lending policies almost unchanged

The slowdown in credit growth is also reflected in the BLS. According to the surveyed bank managers, the demand from non-financial corporations for loans was, on the whole, declining for the first time since the end of 2013. The slump in demand was spread broadly across the euro area Member States. In most of these countries, the surveyed banks connected the decline to enterprises' cyclically-induced lower financing needs for fixed investment. Moreover, the banks explained the slowdown in demand in this loan segment by citing the intensified recourse to alternative sources of funds. By contrast, taken in isolation, the low general level of interest rates, in particular, as well as funding needs for mergers, acquisitions and

4 See Banca d'Italia (2020).

corporate restructuring had a boosting effect on demand. Interest rates for loans to enterprises remained close to their historic lows in the fourth quarter. Once again, lending policies changed only slightly in the fourth quarter according to the bank managers surveyed in the BLS.

Securitised lending supported M3 slightly in Q4

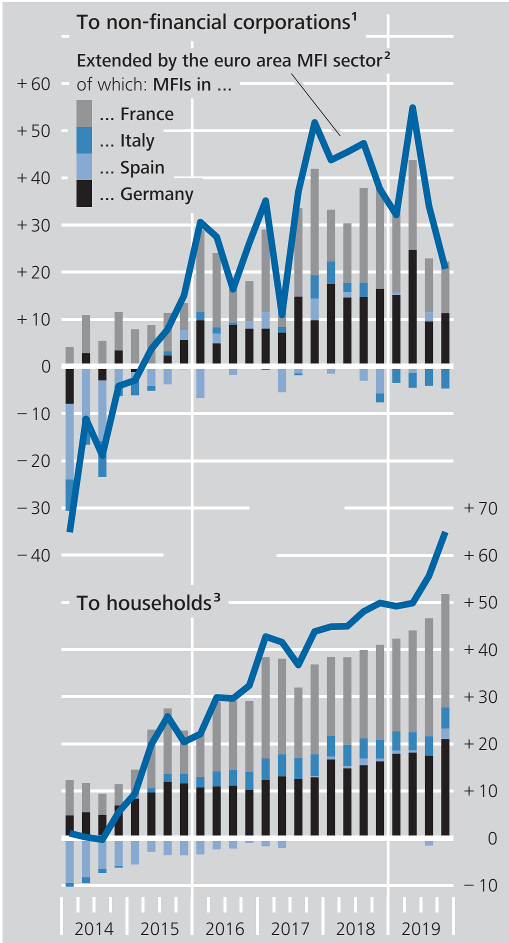
Likewise, securitised lending by the MFI sector to private non-banks and general government in the reporting quarter again contributed slightly to monetary growth on balance. The monthly net purchases of securities by the Eurosystem, which resumed in November 2019, played a key role in this context. Under the APP, the Eurosystem built up its holdings of bonds issued by both the public and the private sector. Commercial banks, on the other hand, showed a preference for purchasing shares and mutual fund shares. Altogether, there was a slight increase in securitised lending, not only to the private sector but also – for the first time since the net purchases were temporarily discontinued in December 2018 – to general government.

Weaker inflow of funds from abroad

Although the inflows to the MFI sector's net external asset position fell significantly short of the three strong preceding quarters, they nevertheless continued to support monetary growth on balance. The item benefited, first and foremost, from the euro area's sustained current account surplus. In terms of securities transactions with non-residents, the net flow of which had likewise been discernibly positive in the preceding quarters, non-resident investors' purchases and the investments of domestic investors virtually balanced each other out of late. According to the balance of payments data available for October and November, non-resident investors, on balance, had a particular appetite for shares and mutual fund shares issued in the euro area. By contrast, resident investors exhibited a greater interest in foreign private-sector bonds. Furthermore, in terms of direct investment, outflows of funds abroad also outweighed inflows of funds over the past few months on balance.

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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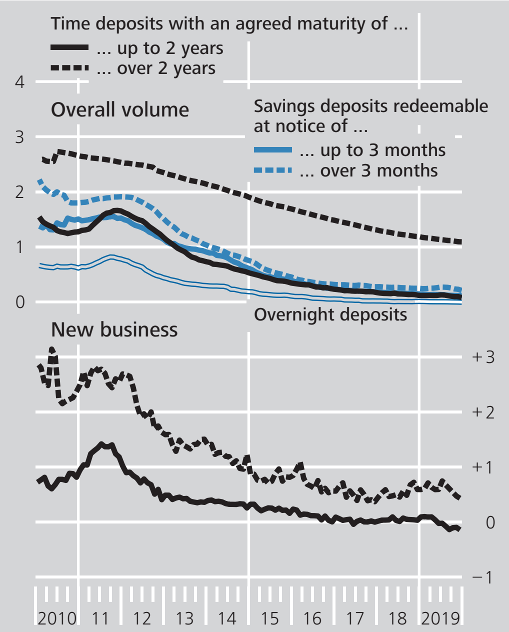
German banks' deposit and lending business with domestic customers

Deposit growth still dominated by build-up of overnight deposits

The expansion in German banks' deposit business with domestic customers in the final quarter of 2019 focused exclusively on overnight deposits. Despite, in some cases, negative interest rates, domestic customers sharply increased their holdings of this type of deposit while scaling back all other forms of deposit, sometimes perceptibly. The main reason for the ongoing build-up of overnight deposits is pre-

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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MFI* lending and deposits in Germany

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

Item	2019 Q3	2019 Q4
Deposits of domestic non-MFIs[1]		
Overnight	38.4	40.1
With an agreed maturity of		
up to 2 years	− 0.1	− 8.5
over 2 years	− 8.3	− 4.6
Redeemable at notice of		
up to 3 months	− 1.2	− 3.0
over 3 months	− 1.2	− 2.5
Lending		
to domestic general government		
Loans	− 2.4	− 0.7
Securities	− 0.2	− 4.3
to domestic enterprises and households		
Loans[2]	26.1	33.4
of which: to households[3]	17.4	21.0
to non-financial corporations[4]	5.0	10.2
Securities	5.1	1.2

* 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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sumably the narrow yield spread offered by alternative bank deposits (see the adjacent chart).

Investment behaviour of the individual sectors unchanged

Sectoral developments in the reporting quarter showed little change against the preceding quarters. Households and, to a lesser extent, non-financial corporations continued to be the main contributors to the increase in overnight bank deposits. By contrast, the more yield-conscious financial institutions built up hardly any overnight deposits, further pursuing the reduction in long-term deposits observed for some time now.[5]

Credit business with non-banks regained momentum owing to loans to the private sector

Banks' credit business with the domestic non-bank sector again saw a marked expansion in the reporting quarter. This was mainly thanks to the sharp increase in lending to the domestic private sector. In addition, banks once again slightly expanded their holdings of securities issued by the private sector, acquiring bonds as well as shares and other variable-yield securities from financial corporations. By contrast, there was a further marked decline in lending to general government. This was particularly true of securitised loans.

Demand for loans for house purchase still high, …

Once more, the largest contribution to the growth in lending to the private sector was made by loans to households. The decisive factor here was households' persistent lively demand for loans for house purchase, of which the pace of growth accelerated further in the reporting quarter. On balance, the growth rate of loans taken out for house purchase further increased to just under 5½% on the year, making it the highest value in 20 years.

… while consumer credit also recorded net inflows

Consumer credit again posted marked positive developments in the reporting quarter. Alongside the persistently favourable labour market and income prospects, the ongoing high demand for bank loans among households in the reporting quarter was also stimulated by exceptionally favourable financing terms. Accord-

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

ing to the MFI interest rate statistics, interest rates on long-term loans for house purchase remained close to their all-time lows at the end of the reporting quarter, while interest rates for long-term consumer credit continued to fall slightly in the reporting quarter.

The latest BLS results provide evidence of further influencing factors. The BLS respondents again stated the good outlook on the housing market and the expected development of house prices as the main reasons for the dynamic growth in the demand for loans to households for house purchase. The sole explanatory factor provided by the surveyed banks regarding the increase in demand for consumer credit was the low general level of interest rates.

Lending policy for loans for house purchase largely unchanged

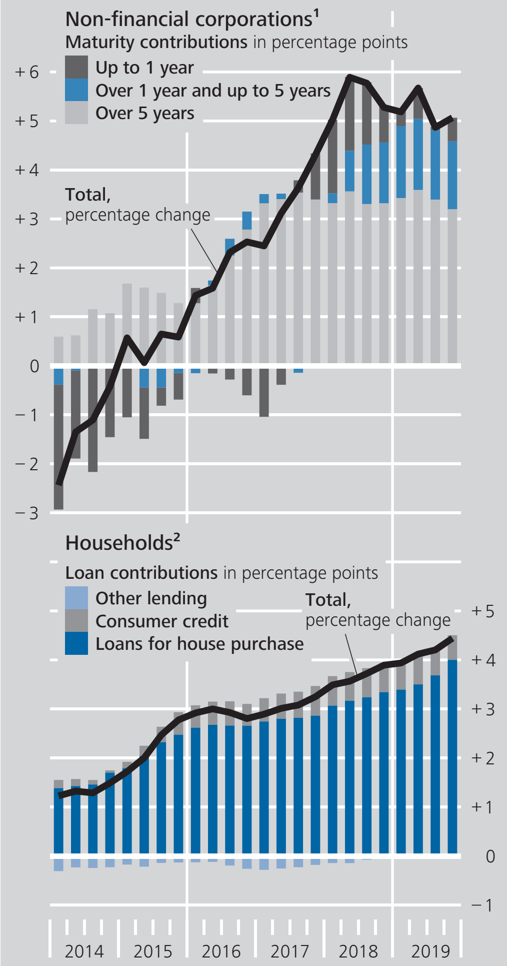
At the same time, no noteworthy restrictive stimuli emanated from the BLS banks' lending policies. As in the previous quarter, the banks participating in the BLS left their credit standards for housing loans unchanged in the reporting quarter, whereas they marginally widened their margins on riskier loans, in particular. Likewise, the surveyed banks saw no need to adjust their standards for consumer loans, but slightly narrowed their margins irrespective of credit rating.

Robust domestic economy boosted demand for loans to enterprises

The lending business of banks in Germany was supported not only by loans to households but also by loans to non-financial corporations, which went back up perceptibly in the reporting quarter. The main reason why net inflows to banks in Germany in this business segment at the euro area level failed to reach their levels from previous quarters was the strikingly weak growth in lending business with non-financial corporations from the rest of the euro area. The latest expansion in lending to enterprises covered all maturities. However, long-term loans recorded the most prominent gains. Although the sustained sluggishness of export-oriented industry dampened investment in machinery and equipment by enterprises in Germany last year, the financing needs of enterprises in the services sector and, in particular, the loan-intensive construction and real estate sector remained high thanks to the robust domestic economy.[6] In addition, the extremely low level of interest rates on long-term loans supported demand in this maturity segment (see the chart on p. 32). Despite the fact that the growth in loans to enterprises has slowed down slightly since mid-2018, it remained relatively high up to the current end at an annual growth rate of just over 5%.

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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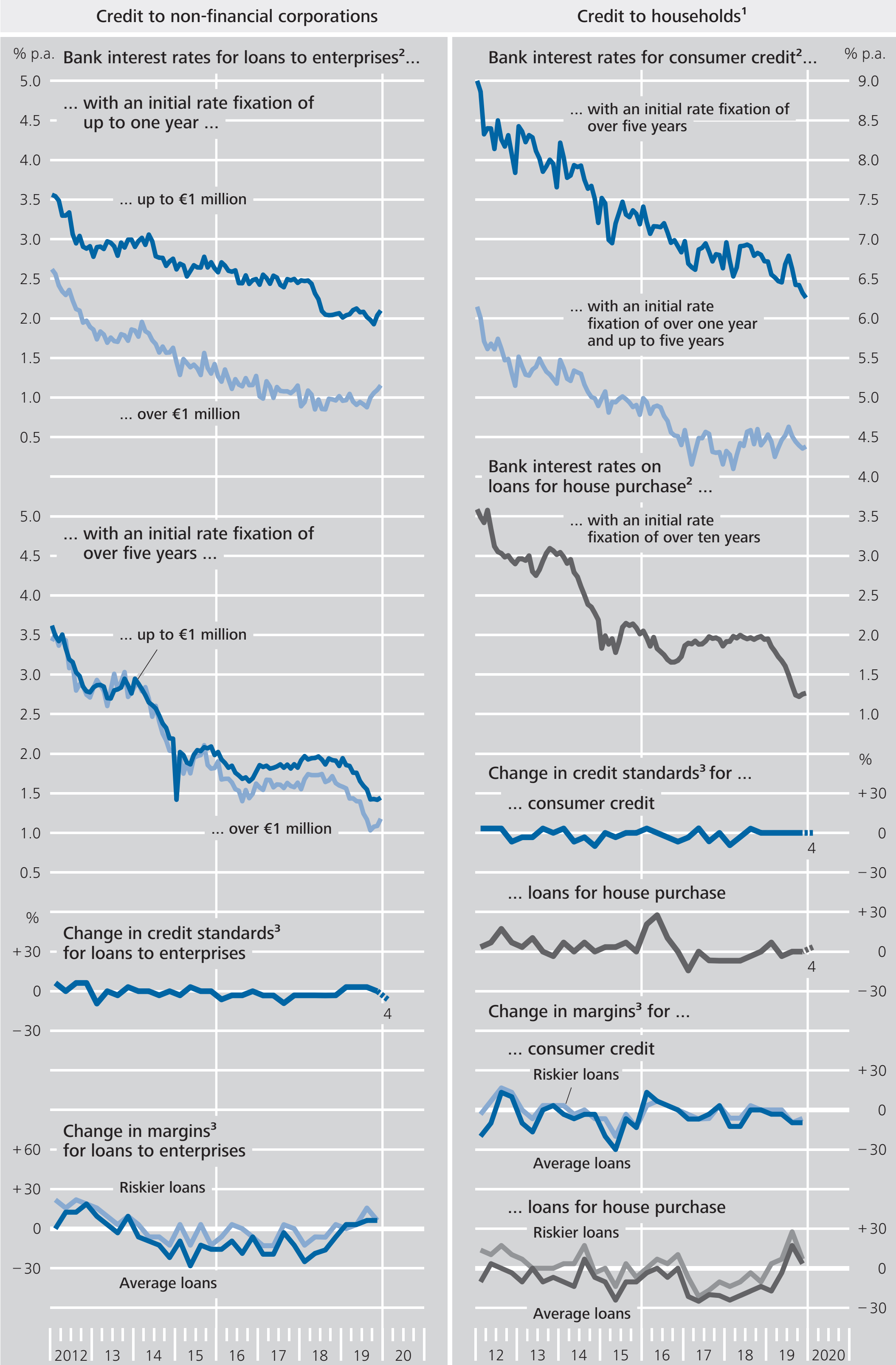
6 See Deutsche Bundesbank (2020).

Banking conditions in Germany



1 Including non-profit institutions serving households. **2** New business. According to the harmonised MFI interest rate statistics. **3** According to the Bank Lending Survey; for credit standards: difference between the number of respondents reporting "tightened considerably" and "tightened somewhat" and the number of respondents reporting "eased somewhat" and "eased considerably" as a percentage of the responses given; for margins: difference between the number of respondents reporting "widened considerably" and "widened somewhat" and the number of respondents reporting "narrowed somewhat" and "narrowed considerably" as a percentage of the responses given. **4** Expectations for Q1 2020.

Deutsche Bundesbank

Demand supported mainly by low level of interest rates

This is largely consistent with the results of the BLS. According to the bank managers, the demand for longer-term loans in the reporting quarter was more dynamic than for short-term loans. Alongside financing needs for fixed investment as well as for refinancing, debt restructuring and renegotiation, the low general level of interest rates, in particular, had a boosting effect on demand when viewed in isolation. The MFI interest rate statistics show that, at the end of December 2019, domestic enterprises paid interest amounting to 1.4% for small-volume and 1.2% for large-volume loans in the long-term segment, while interest on short-term loans stood at 2.1% and 1.2%, respectively, of late (see the chart on p. 32). On the other hand, the BLS revealed that demand was being dampened by enterprises' ability to fall back on alternative sources of funding; however, the impact of these sources has waned discernibly since autumn 2018.

Standards for loans to enterprises unchanged; credit terms and conditions slightly restrictive

At the same time, the latest BLS results indicate that the banks made their lending policies for loans to enterprises slightly more restrictive for the fourth consecutive time. The surveyed banks reported having further widened their margins on balance, irrespective of borrowers' creditworthiness, citing the restrictive impact of the cost of funds along with balance sheet constraints as the main reasons. However, the credit standards for loans to enterprises remained unchanged across all survey categories in the reporting period.

Regulatory and supervisory activities, when viewed in isolation, leading to tightened credit standards; impact of NPL ratio neutral by comparison

Against the backdrop of the situation in the financial markets, the German banks, in response to the ad hoc questions in the January BLS, reported virtually no change in their funding situation compared with the previous quarter. In the wake of the new regulatory and supervisory activities, they continued to strengthen their capital position in the second half of 2019. In addition, these activities had a tightening effect on credit standards when taken in isolation. During the same period, the ratio of NPLs to the gross book value of loans did not prompt the surveyed banks to change their lending policies.

TLTRO-III funds used chiefly for lending to the non-financial private sector and to substitute TLTRO-II funds

Four banks from the German sample of the BLS took part in the second TLTRO-III, conducted in December 2019. The reason they gave for taking part was mainly to capitalise on the attractive terms and conditions of the operation. These banks reported using the funds to substitute TLTRO-II funds. In keeping with the monetary policy purpose of the measure, they wish to use the liquidity for lending to the non-financial private sector. TLTRO-III had a positive direct or indirect effect on the banks' financial situation through improved funding conditions and a more comfortable liquidity position. It had no impact on credit standards or credit terms and conditions, however.

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