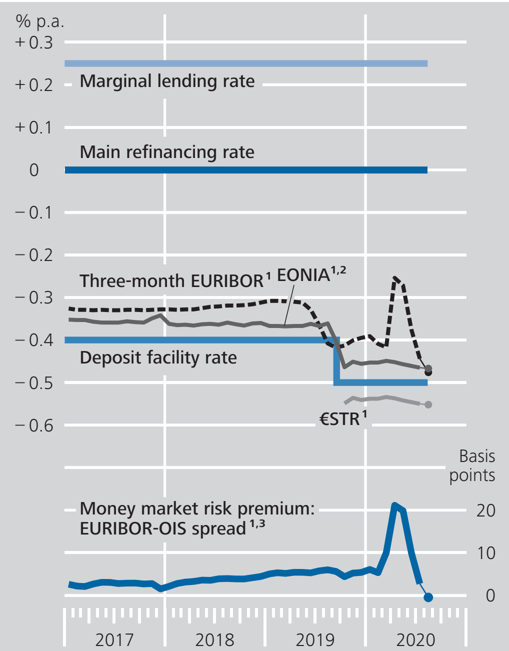
Monetary policy and banking business

Monetary policy and money market developments

ECB Governing Council decides to increase and extend PEPP

At its monetary policy meeting in June 2020, the Governing Council of the European Central Bank (ECB) decided to expand the pandemic emergency purchase programme (PEPP) in two ways. First, it increased the envelope for the programme by €600 billion to a total of €1,350 billion. Purchases will continue to be conducted in a flexible manner over time, across asset classes and among jurisdictions. Second, the Governing Council decided to extend the horizon for net purchases under the PEPP to at least the end of June 2021. In any case, net asset purchases under the PEPP will continue to be conducted until the Governing Council judges that the coronavirus crisis phase is over. The Governing Council also decided to reinvest the maturing principal payments from securities purchased under the PEPP until at least the end of 2022. In any case, the future roll-off of the PEPP portfolio will be managed to avoid interference with the appropriate monetary stance. The Governing Council left the asset purchase programme (APP) and the Eurosystem's key interest rates unchanged, meaning that the main refinancing rate remains at 0%, while the rate of the marginal lending facility stands at 0.25% and the deposit facility rate at -0.5%.

Money market interest rates in the euro area



Sources: ECB and Bloomberg. **1** Monthly averages. **2** From 1 October 2019, EONIA calculated as €STR + 8.5 basis points. **3** Three-month EURIBOR less three-month EONIA swap rate. • Average 1 to 13 August 2020.

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PEPP expanded in response to downward revision of inflation outlook

The Governing Council considered the expansion of the PEPP to be an appropriate response to the pandemic-related downward revision to the inflation path expected for the coming years. It based this assessment on the new Eurosystem staff macroeconomic projections. Compared with March 2020, these projections have been revised substantially downwards over the entire projection horizon, despite the recovery anticipated for the second half of the year. Furthermore, the Governing Council sees the balance of risks around the baseline projection to the downside. Against this backdrop, the PEPP expansion is expected to further ease the general monetary policy stance, supporting funding conditions in the real economy, especially for businesses and households. The flexible conduct of purchases will also allow the Governing Council to effectively stave off risks to the smooth transmission of monetary policy.

Monetary policy stance confirmed after July meeting

The Governing Council reconfirmed its very accommodative monetary policy stance following its July meeting. Incoming information signals a resumption of euro area economic activity since May, with both high-frequency and survey indicators in May and June rebounding perceptibly. At the same time, actual and expected job and income losses and the exceptionally elevated uncertainty continue to weigh on consumer spending and business investment, in the Governing Council's opinion. Headline inflation is currently being dampened by lower

Money market management and liquidity needs

In the two reserve maintenance periods under review running from 6 May 2020 to 21 July 2020, liquidity needs stemming from autonomous factors rose by a substantial €310.1 billion to €1,868.8 billion (see the table below).[1] This was due primarily to the sharp rise in government deposits with the Eurosystem. In the June-July 2020 period, they averaged €671.2 billion, which was €296.8 billion, or around 80%, higher than the average for the March-May 2020 period (see the chart on p. 30). Deposits held at the Bundesbank contained therein doubled to €205.0 billion. The rise in government deposits reflected the expected increase in governments' economic stimulus expenditure. Continued high net demand for banknotes also contributed to the uptick in liquidity needs. In the wake of the coronavirus pandemic, the volume of banknotes in circulation issued by the Eurosystem also rose sharply again, by €43.8 billion to €1,365.7 billion, with cumulative net banknote issuance by Germany increasing by €13.5 billion to €789.8 billion. The rise in the combined total of net foreign assets and other factors, which are considered together owing to liquidity-neutral valuation effects, had a liquidity-providing effect, by contrast. The €30.5 billion increase in the aggregate value reduced liquidity needs by a similar amount. Over the reporting period, the minimum reserve requirement climbed by €5.5 billion to €141.2 billion in the June-July 2020 reserve period, which led to an additional need for central bank liquidity. In

1 Average of the fourth reserve maintenance period (June-July 2020) as compared to the average of the second reserve maintenance period of 2020 (March-May 2020), which was covered in the May 2020 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	2020 6 May to 9 June	2020 10 June to 21 July
I. Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors		
1. Banknotes in circulation (increase: –)	– 26.0	– 17.8
2. Government deposits with the Eurosystem (increase: –)	– 102.7	– 194.1
3. Net foreign assets[1]	+ 24.1	– 79.1
4. Other factors[1]	– 41.9	+ 127.4
Total	– 146.5	– 163.6
II. Monetary policy operations of the Eurosystem		
1. Open market operations		
a) Main refinancing operations	– 0.3	+ 0.5
b) Longer-term refinancing operations	+ 118.5	+ 417.3
c) Other operations	+ 202.7	+ 181.3
2. Standing facilities		
a) Marginal lending facility	+ 0.0	+ 0.0
b) Deposit facility (increase: –)	– 28.1	– 56.1
Total	+ 292.8	+ 543.0
III. Change in credit institutions' current accounts (I. + II.)	+ 146.3	+ 379.4
IV. Change in the minimum reserve requirement (increase: –)	– 3.7	– 1.8

* 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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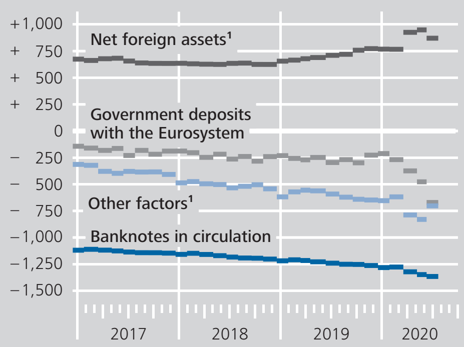
Autonomous factors in the Eurosystem*

€ 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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Eurosystem purchase programmes

€ billion

Programme	Change across the two reserve periods	Balance sheet holdings as at 7 August 2020
Active programmes[1]		
PSPP	+ 65.4	2,263.7
CBPP3	+ 6.9	284.7
CSPP	+ 16.2	225.9
ABSPP	− 0.7	30.1
PEPP	+ 280.0	453.9
Completed programmes		
SMP	− 4.0	34.6
CBPP1	− 0.3	0.5
CBPP2	− 0.0	2.9

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

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Germany the reserve requirement went up by €1.7 billion to €38.8 billion.

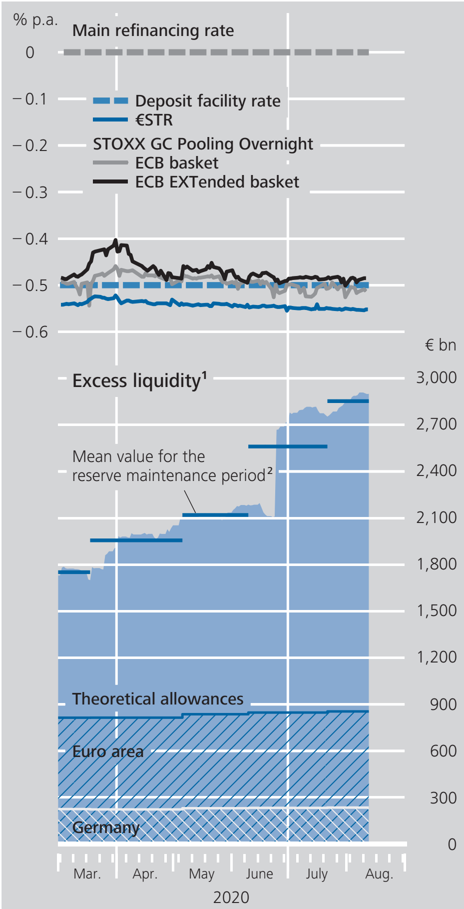
In the reporting period, the outstanding tender volume increased considerably (see the chart on p. 32). At €1,402 billion for the June-July 2020 period, the average volume was €536 billion higher than in the March-May 2020 period. This increase was attributable primarily to the fourth operation of the third series of targeted longer-term refinancing operations (TLTRO-III), which was settled on 24 June and experienced very strong demand of €1,308 billion owing to the attractive conditions. There were 742 bidders; this high number underscored the broad interest in the operations. Even before the settlement of the fourth TLTRO-III operation, there was a visible increase in the outstanding tender volume as demand gradually picked up for the additional longer-term refinancing operations, which were used to bridge the gap until the fourth TLTRO-III operation. The outstanding tender volume of these operations rose to €389 billion up to maturity, an increase of €77 billion compared with the end of the March-May 2020 period. Demand for liquidity in the first two pandemic emergency longer-term refinancing operations (PELTROs) totalled €16.5 billion. The bulk of this sum, €15.6 billion, was likewise settled on 24 June. The net liquidity effect on this day was reduced by the maturing of the additional longer-term refinancing operations amounting to €389 billion and of the first TLTRO-II operation amounting to €157 billion. In addition, early voluntary repayments of €214 billion were made on the remaining TLTRO-II operations. On balance, there was a net liquidity injection of €564 billion on 24 June. In Germany, too, the outstanding volume of longer-term refinancing operations grew considerably overall in the period under review and, at €235 billion, was more than twice as high as in the reference period. On the other hand, demand in the regular tender operations, i.e. the main refinancing operations and three-month tenders, remained extremely low over the period under review.

It was not only the significant increase in the outstanding tender volume but also, to a lesser yet still large extent, the Eurosystem's asset purchase programmes which provided additional liquidity. Holdings under these programmes averaged €3,168 billion in the June-July 2020 period, around €384 billion above that of the March-May 2020 period. Factors in this development were the pandemic emergency purchase programme (PEPP) and the asset purchase programme (APP) (see the adjacent table).

On balance, excess liquidity rose significantly over the reporting period. The €171 billion increase between the March-May and May-June periods was followed by a sharp rise by an additional €434 billion in the subsequent June-July period, with excess liquidity reaching an average of €2,561 billion. However, the above-mentioned increase in the autonomous factors slowed the rise in excess liquidity. Eurosystem banks used 98.4% of the exemption allowance under the two-tier system for remunerating excess reserve holdings in the June-July 2020 period, a slight increase compared with the March-May 2020 period. In Germany, utilisation was still below the Eurosystem average, but also rose slightly to 97.8%. Moreover, the increase in reserve requirements caused the absolute exemption allowances to rise during the reporting period. However, given the much stronger growth in excess liquidity, excess reserves, remunerated at -0.50%, increased even further (see the adjacent chart). This meant that, on average, around 33% of excess liquidity in the Eurosystem was exempted from remuneration at negative interest rates in the June-July 2020 period, compared with around 41% in the March-May 2020 period.

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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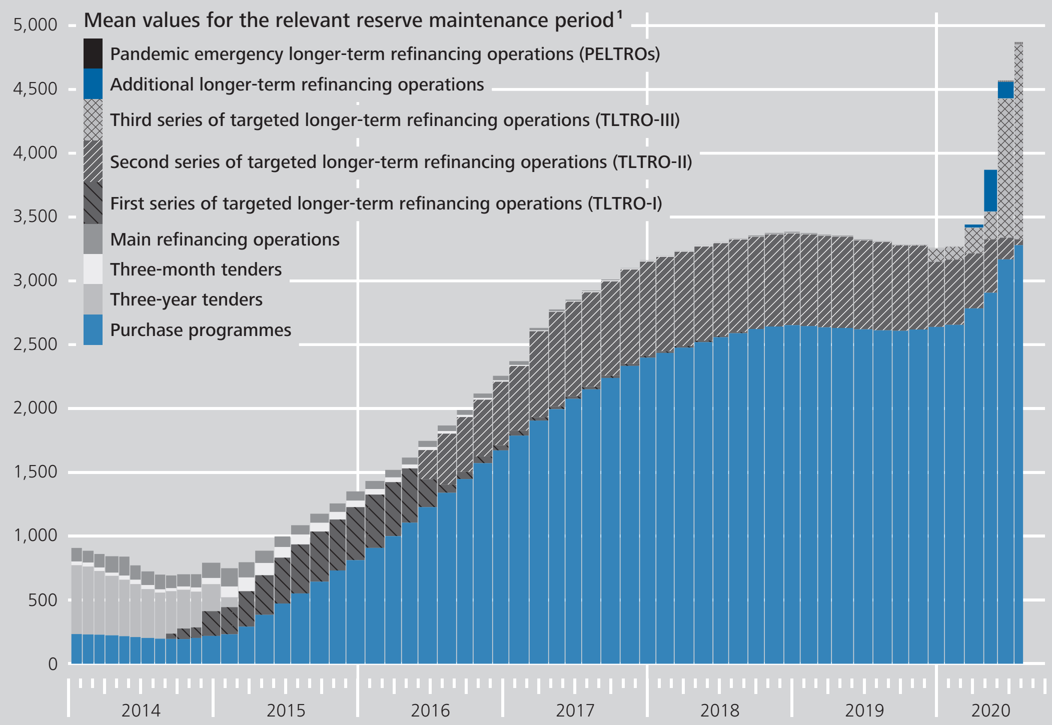
In the money market, interest rates fell during the reporting period in the light of the considerable increase in excess liquidity (see the adjacent chart). The secured market saw overnight rates in GC Pooling decline for both the ECB basket and ECB EXTended basket (which contains an extended pool of collateral) by 3 basis points to -0.51% and -0.49%, respectively. Turnover on the GC Pooling platform also dropped: the secured transactions with a maturity of one day (ON, TN, SN; Deferred Funding Rate) generated average turnover of €10.7 billion in the June-July 2020 reserve period, while average turnover before allotment of the fourth TLTRO-III operation in the May-June 2020 period was €14.5 billion. By comparison, the impact on the unsecured overnight rate €STR was more limited, which is likely to be partly due to the fact that €STR predominantly contains transactions with non-banks. €STR fell by 1 basis point to -0.55% in the two reserve maintenance periods. In addition, €STR volumes remained broadly stable before then rising by an average of around €1 billion to €42 billion following the settlement of the fourth TLTRO-III operation. In longer-term segments of the secured market (GC Pooling), turnover remained low for three-month transactions and declined overall in the six-month segment. The abundance of longer-term central bank liquidity during the reporting period is likely to have had an even greater impact on this market than on the very short-term segments.

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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energy prices, and price pressures are expected to remain very subdued on account of the sharp decline in real GDP growth and the associated significant increase in economic slack. Against this background, the Governing Council takes the view that ample monetary stimulus remains necessary to support the economic recovery and safeguard medium-term price stability.

New repo facility to provide euro liquidity to non-euro area central banks

On 25 June 2020, the Governing Council decided to set up a new backstop facility, called the Eurosystem repo facility for central banks (EUREP), to provide precautionary euro repo lines to central banks outside the euro area. Specifically, EUREP was created to address possible euro liquidity needs in case of market dysfunction resulting from the COVID-19 shock that might adversely impact the smooth transmission of ECB monetary policy. Under EUREP, the Eurosystem will provide euro liquidity to a broad set of central banks outside the euro area against adequate collateral, consisting of euro-denominated marketable debt securities issued by euro area central governments and supranational institutions. EUREP complements the ECB's bilateral swap and repo lines and will be available until the end of June 2021.

APP and PEPP add further to securities holdings recorded on balance sheet

APP holdings recorded on the balance sheet rose by €88.7 billion during the reporting period, which means that the stock of APP assets held by the Eurosystem on 7 August 2020 came to a total of €2,804.3 billion (a breakdown of these holdings by individual asset purchase programme can be found in the box on pp. 29 ff.). The holdings are furthermore being influenced by the smoothing over time of reinvestments in line with the technical parameters agreed upon in December 2018 and by the use of amortised cost accounting.[1] Securities holdings reported under the PEPP

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

amounted to €453.9 billion on 7 August 2020, up by €301 billion.

Fourth TLTRO-III attracts record demand

On 24 June 2020, the fourth operation of the third series of targeted longer-term refinancing operations (TLTRO-III) was settled, and saw banks take up a total of €1,308.4 billion, the highest allotment to date in a single Eurosystem refinancing operation. The twice-adjusted, extremely favourable interest rate of up to -1% between June 2020 and June 2021, which is below the Eurosystem's deposit facility rate, is likely to have been a key reason for the brisk demand. At the same time, monetary policy counterparties voluntarily repaid €214 billion of funds from the second series of targeted longer-term refinancing operations (TLTRO-II). Furthermore, the first TLTRO-II operation matured, with an additional €158 billion being repaid. Moreover, the additional longer-term refinancing operations (LTROs) which the Governing Council adopted in March to bridge the gap until the fourth TLTRO-III expired. These transactions saw an amount of €388.8 billion fall due for repayment. Together, the TLTRO-II and TLTRO-III series currently have an outstanding volume of around €1,570 billion.

Demand for PELTROs still weak

Demand in the second and third operations of the series of pandemic emergency longer-term refinancing operations (PELTROs), which were settled on 24 June and 6 August 2020, remained relatively subdued, with credit institutions taking up €15.6 billion and €5.7 billion.

Excess liquidity hits new peaks

Allocation of the fourth TLTRO and the continued asset purchases, in particular, caused excess liquidity to increase even more steeply than it had in the previous reporting period. At last count, the excess liquidity volume recently reached a new peak of €2,908 billion, up by around €786 billion. The liquidity-absorbing factors counterbalancing the increase in excess liquidity rose further as well (see the box on pp. 29 ff.).

Short-term money market rates down

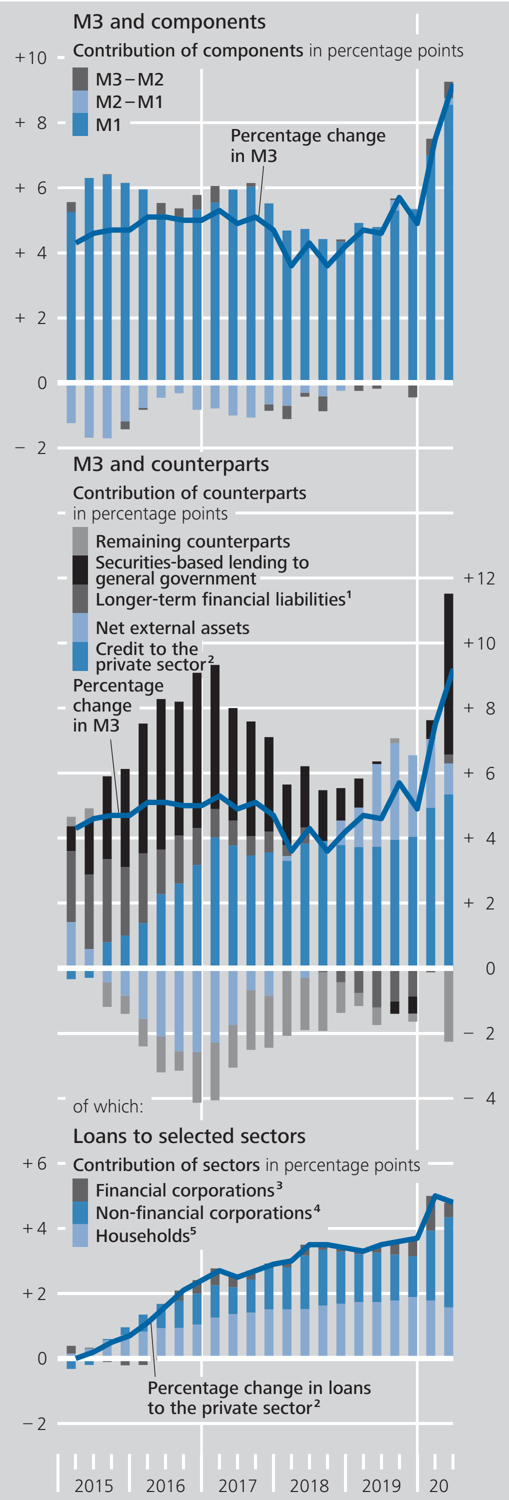
Short-term money market rates declined overall in recent weeks. The unsecured euro overnight index average rate (EONIA), which is computed by applying a fixed spread to the euro short-term rate (€STR), trended slightly lower, closing the period under review at -0.47%. This was probably because of the continued strong increase in excess liquidity, which caused the portion of excess liquidity remunerated at the negative deposit facility rate to increase sharply as well. The introduction of the two-tier system (TTS) at the end of October 2019 reduced the share of banks' excess reserves remunerated at the negative deposit facility rate and sent €STR and EONIA slightly higher at the time. Far stronger declines were registered by the three-month euro interbank offered rate (EURIBOR), which plummeted from -0.25% in mid-May to -0.46% as this report went to press. This more than reversed the sharp rise that this rate had previously recorded in March and April, leaving it currently roughly on a par with EONIA. However, in a departure from earlier episodes, this marked convergence of the three-month EURIBOR rate with EONIA is probably not being fuelled by mounting expectations of a rate cut in the next three months, given that money market forward rates are not signalling any such expectations. A more likely explanation is that the extensive provision of liquidity has significantly eroded the importance of the factors that had driven the increase in the three-month EURIBOR rate in the first place. At the onset of the coronavirus crisis, these factors included, amongst others, an increased preference among market participants for very short maturities and interest rate increases in neighbouring market segments, which can serve as inputs in the calculation of EURIBOR.

Money market forward rates still pricing in a possible interest rate cut

Money market forward rates climbed significantly at times in June, though they closed the period only a shade higher than their mid-May level. The low point of the curve has now shifted further into the future and is currently projected to reach -0.54% in the second quarter of 2022. A 10-basis-point reduction in the deposit facility rate as from mid-2021 is therefore not fully priced into forward rates, but the growing likelihood of one is. That said, market participants' expectations about how liquidity conditions will develop might also have a bearing on how money market forward rates evolve. In the latest surveys, conducted ahead of the Governing Council's monetary policy meeting in July, the median of survey participants' responses was, just like in June, that they were not expecting the deposit facility rate to be reduced.

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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Monetary developments in the euro area

Monetary developments shaped by coronavirus pandemic: strong rise in overnight deposits and …

The coronavirus pandemic and the measures taken to contain it had a major bearing on monetary developments in the second quarter of 2020, with overnight deposits, in particular, registering strong gains. This meant that the steep increase in the broad monetary aggregate M3 observed in the previous quarter continued into the reporting period. By the end of June, the annual growth rate of M3 had risen to 9.2%, a level last seen in the summer of 2008.

… brisk growth in credit, particularly to non-financial corporations and government

As for the counterparts, monetary growth in the second quarter was driven almost exclusively by credit to residents, with credit to the private sector making the largest contribution, followed by securitised lending to government. The increases in these two positions also had a great deal to do with the effects of the coronavirus pandemic: The strong growth in credit to the private sector was mainly attributable to credit to non-financial corporations, which is likely to have been stimulated by the various government support programmes and emergency measures taken by governments to prop up the corporate sector during the crisis. Many enterprises used these credits to bridge revenue shortfalls and avoid future liquidity shortages. By contrast, loans to households, which until early 2020 had been on a stable upward path, weakened significantly, particularly in the countries that were especially affected by the pandemic. The significantly expanded overall volume of the asset purchase programmes led

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

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

Assets	Q1 2020	**Q2 2020**	Liabilities	Q1 2020	**Q2 2020**
Credit to private non-MFIs in the euro area	232.9	195.3	Holdings against central government[2]	63.2	262.9
Loans	249.9	101.8	Monetary aggregate M3	473.6	404.7
Loans, adjusted[1]	242.2	111.1	of which components:		
Securities	– 16.9	93.6	Currency in circulation and overnight deposits (M1)	388.3	362.2
Credit to general government in the euro area	133.8	506.1	Other short-term deposits (M2-M1)	3.7	41.2
Loans	21.8	– 2.0	Marketable instruments (M3-M2)	81.6	1.4
Securities	112.0	508.1	Longer-term financial liabilities	– 47.6	– 3.8
			of which:		
Net external assets	72.5	– 44.0	Capital and reserves	9.2	16.0
Other counterparts of M3	49.9	6.4	Other longer-term financial liabilities	– 56.7	– 19.7

***** 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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to higher purchases of government bonds by the Eurosystem. Other monetary financial institutions (MFIs) likewise added substantially to their holdings of government bonds in the second quarter on balance, which came as a result of the large-scale issuance of government paper, for which domestic banks are the natural first buyers. Central governments set aside some of their borrowing to cover future expenditure on combatting the coronavirus crisis by holding it in the form of deposits with the MFI sector, which dampened monetary growth when viewed in isolation.

Overnight deposits see strong inflows again

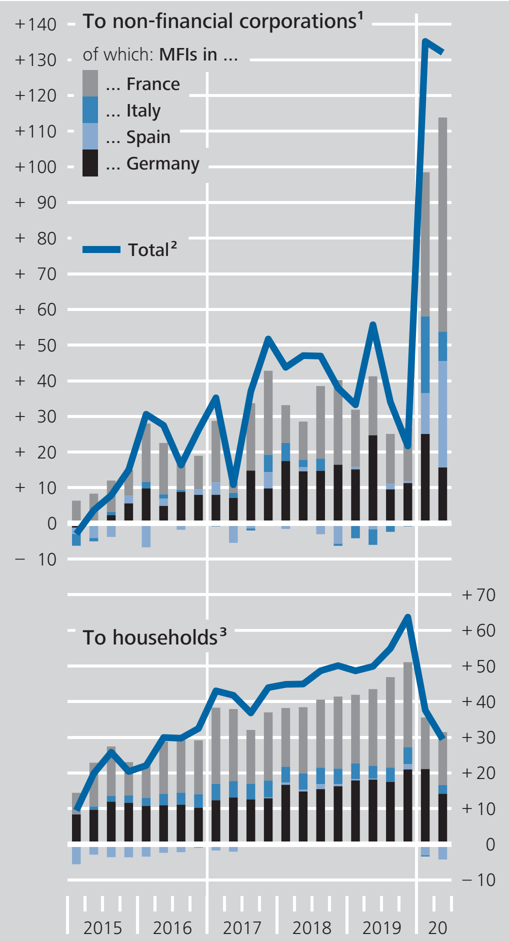
Among the components, overnight deposits were a major driver of the money supply. Total inflows for the period once again far outpaced any other pre-outbreak quarter, though they were slightly down on the previous quarter's figure. Lingering acute uncertainty surrounding the impact of the coronavirus pandemic probably encouraged market participants to stick to liquid investments and avoid longer-term financial commitments. Non-financial corporations also stepped up their holdings particularly strongly this quarter, followed by households. Continued strong demand for cash was another phenomenon typically seen in a crisis situation. A monthly comparison, however, reveals that net inflows into overnight deposits and currency dwindled almost continuously until June compared with March, which could be read as indicating that conditions are returning to normal, albeit very slowly.

Domestic credit dominates counterparts

Viewed in terms of counterparts, monetary growth was dominated by the uptick in domestic credit, with credit to the private sector contributing just over 5 percentage points to the annual rate of M3. Credit to general government made a somewhat smaller contribution and consisted exclusively of net purchases of government bonds. This contrasted with a sharp upturn in euro area central government deposits with the MFI sector, which are being kept as a liquidity reserve for future expenditure on combatting the coronavirus crisis and dampened monetary growth when viewed in isolation. While the Eurosystem accounted for a large share of the government bond purchases, other MFIs also boosted their stocks of mostly domestic government bonds on balance. Lending to the private sector was driven by loans to non-financial corporations in particular, while loans to non-monetary financial corporations saw some net repayments again recently, after posting robust growth in the previous quarter. Furthermore, securitised lending to the corporate sector recorded significant inflows in the second quarter on the back of the Eurosystem's net purchases.

MFI 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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Brisk growth in loans to non-financial corporations buoyed by government support measures

In the spring quarter, the increase in loans to non-financial corporations continued to be driven by the brisk demand for loans brought about by the crisis and once again matched the previous quarter's level overall. Monthly inflows did, however, ease off again as the reporting quarter progressed, after loans had risen exceptionally sharply in March due to the crisis. Loans with short maturities of up to one year, which had contributed substantially to credit growth at the onset of the coronavirus pandemic, were redeemed in net terms, while longer-dated loans, buoyed by government support measures, increased all the more.

Lending developments were mixed in the large Member States. While the inflow in Germany moved in line with the average of the past two years, inflows in France, Spain and Italy were well up on the corresponding same-period figures. To a large extent, this mixed picture can be put down to Germany's more upbeat economy, which meant that enterprises there needed less liquidity, relatively speaking, than their peers elsewhere in the euro area, as shown by the fact that German enterprises have made only partial use so far of the credit lines granted to them. Another explanatory factor is that the government-backed assistance loans were offered relatively cheaply in some euro area countries. For instance, the aggregate interest rate on loans to enterprises in France fell by around ½ percentage point over the course of the quarter under review. In Germany, by contrast, that same interest rate rose slightly, particularly in the longer maturity buckets supported by government assistance loans.

BLS data confirm brisk demand

Data reported by bank managers surveyed as part of the Bank Lending Survey (BLS) confirmed that demand-side factors were the main reason why credit growth was so robust. The latest round of the BLS revealed that the net percentage of banks which reported an uptick in demand for loans to enterprises in the second quarter of 2020 was even higher than in the previous three-month period. Respondents stated that demand among small and medium-sized enterprises, buoyed by the attractive terms offered in the government support programmes, was stronger than that shown by large firms. Banks reported that the brisker uptake of loans in response to the coronavirus crisis had mainly been brought about by the high financing needs for inventories and working capital as well as for refinancing, debt restructuring and renegotiation. Demand was dampened, on the other hand, by declining funding requirements for fixed investment and for mergers, acquisitions and restructuring. Euro area banks surveyed as part of the BLS left their lending policies more or less unchanged in the second quarter of 2020 on balance.

Lending to households remains weak

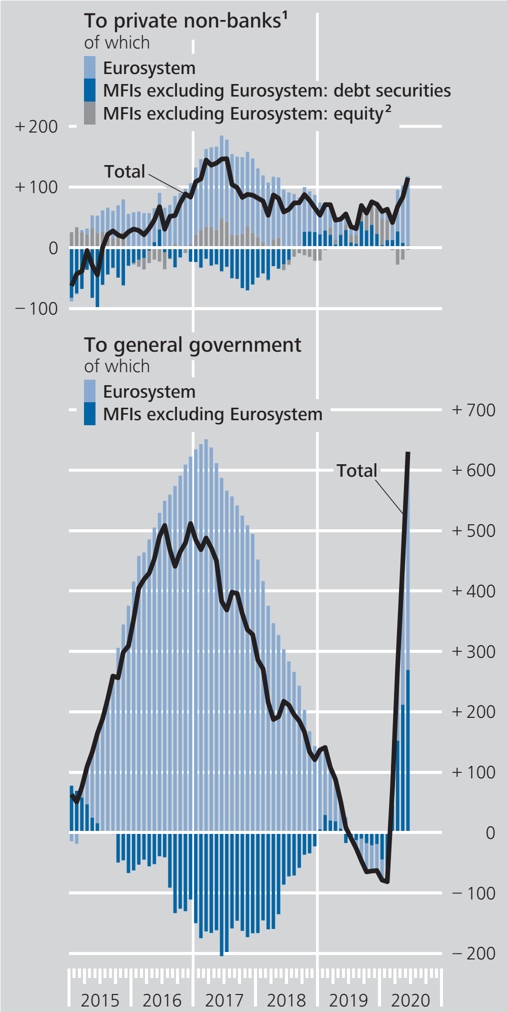
In terms of loans to euro area households, the marked slowdown observed in the previous quarter in the wake of the coronavirus pandemic continued. The year-on-year rate of increase fell further to 3.0% at the end of the quarter. Consumer loans, in particular, again recorded strong net outflows, although these declined somewhat over the course of the quarter. In the case of loans for house purchase, net inflows remained weak in April in particular as a result of the crisis, but likewise recovered over time, bringing the overall quarterly increase close to the average level of the previous two years. By contrast, other loans, which mainly include loans to self-employed persons, rose comparatively sharply, particularly as a result of high contributions from Italy and Spain.

According to BLS, decline in loans to households has both demand-side and supply-side causes

The data provided by the bank managers surveyed in the BLS show that negative assessments in the area of retail banking owing to the coronavirus crisis were more widespread than in the previous quarter. This concerned both the demand side and the supply side of lending. The net percentage of surveyed euro area banks reporting a decline in households' demand for loans in the second quarter rose to its highest level since the financial crisis, while the net percentage of surveyed institutions reporting tighter credit standards for retail banking increased significantly. According to the banks, less favourable assessments of credit risks and a lower risk tolerance were reasons for this tightening. A considerable loss of consumer confidence was cited by the banks surveyed as the main reason for the decline in demand. In the area of consumer loans and other loans, a sharp decline in the need for funds to finance durable consumer goods was cited as another major reason. With regard to loans for house purchase, the negative outlook in the housing market and households' expectations of house price developments contributed significantly to the decline in demand, according to banks' assessments. For the third quarter, banks expect a net pick-up in demand for building loans to households alongside a further tightening of standards.

Securities-based lending in the euro area

€ billion, 12-month accumulated flows



Sources: ECB and Bundesbank calculations. **1** Eurosystem: debt securities only; other MFIs: debt securities and equity. **2** Shares and other equities.
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Record inflows into securitised lending by the Eurosystem and commercial banks

Net inflows into securitised lending in the second quarter were higher than at any point since the start of monetary union. This development was driven almost exclusively by net purchases of government-issued securities. These net purchases of government bonds mainly reflected the Eurosystem's activities in the context of the asset purchase programmes (APP and PEPP), which were expanded again as a result of the crisis. However, commercial banks also recorded a strong net increase in their holdings of government bonds. They boosted their holdings of government bonds issued in their home country in April and May, in particular. This is likely to have been due to the increased issuance of new government securities as part of the fiscal pandemic measures. In June, commercial banks' net purchases fell to their usual levels and were once again more broadly spread across the euro area. Bonds issued by private issuers were also in demand in the second quarter, albeit to a much lesser extent and for the most part only by the Eurosystem as part of the asset purchase programmes. By contrast, given that stock prices were still subdued at the beginning of the second quarter and there was a high degree of uncertainty surrounding future price developments, it was not until the easing of contact restrictions began, which boosted hopes of a normalisation in the near term, that banks again made net acquisitions of shares and investment fund shares.

Slight dampening impact on M3 from cross-border flows of goods and capital

The MFI sector's net external asset position slightly dampened monetary growth on balance in the quarter under review. According to the non-seasonally adjusted balance of payments data, thus far available only for April and May, this was due, in particular, to significantly lower current account surpluses in the euro area as a result of the weak global economic development in the wake of the crisis. In a countermovement to the previous quarter, both domestic non-MFIs and non-residents made net acquisitions of securities from the other respective economic area, as capital flows recovered somewhat as a result of rising turnover. However, net capital exports from the euro area predominated. Domestic non-MFIs purchased long-term bonds as well as shares and investment fund shares of foreign issuers. On balance, in light of higher risk premiums, non-residents sold long-term debt securities issued by the domestic private non-MFI sector, while acquiring mainly short-term government debt securities as well as shares and investment fund shares.

German banks' deposit and lending business with domestic customers

Renewed expansion of deposit business, but weaker than in previous quarter

German banks' deposit business with domestic customers was also dominated by a strong increase in overnight deposits in the second quarter of 2020. At the same time, however, bank customers increasingly reduced their time deposits, which meant that growth in deposit business weakened considerably on balance compared with the exceptionally strong growth in the previous quarter. A key reason for this was the general government sector's large-scale reduction in time deposits. It can be assumed that this is linked to the high coronavirus-related financing needs of the general government sector excluding central government. In addition, the easing of the situation in the financial markets prompted financial corporations to shift a significant portion of their holdings of overnight deposits that were built up in the previous quarter back into more profitable forms of investment.

Liquidity preference of households and non-financial corporations remains high

By contrast, in the reporting quarter, households and non-financial corporations increased their holdings of highly liquid bank deposits even more significantly than in the previous quarter, with some funds being shifted out of longer-term bank deposits. In the quarter under review, these investors thus continued to show an exceptionally strong preference for liquidity, which probably also reflected the persistently high level of uncertainty about the future of the pandemic and the economic recovery path. The low interest rates additionally favoured this decision (see also the box on pp. 40 ff.). At the same time, the remarkably strong build-up of overnight deposits in the reporting quarter was supported by the fact that much of the other usual consumer spending for this time of year was not made due to pandemic-related restrictions.

Strong expansion in credit business with non-banks

German banks' lending business with domestic customers was remarkably strong in the first quarter in the wake of the coronavirus crisis.

This did not continue with the same momentum in the second quarter of 2020, with net lending instead expanding at a similar pace to that seen before the outbreak of the pandemic. In addition to increasing their lending to the domestic private sector, in the reporting period German banks once again recorded a marked increase in their holdings of securities issued by public issuers. The upturn in lending to the general government sector observed as of March is likely to reflect this sector's increased financing needs as a result of the coronavirus crisis, which are attributable not least to extensive support measures to cope with the economic consequences of the pandemic.

Longer-term loans to enterprises up sharply, bolstered by government guarantees

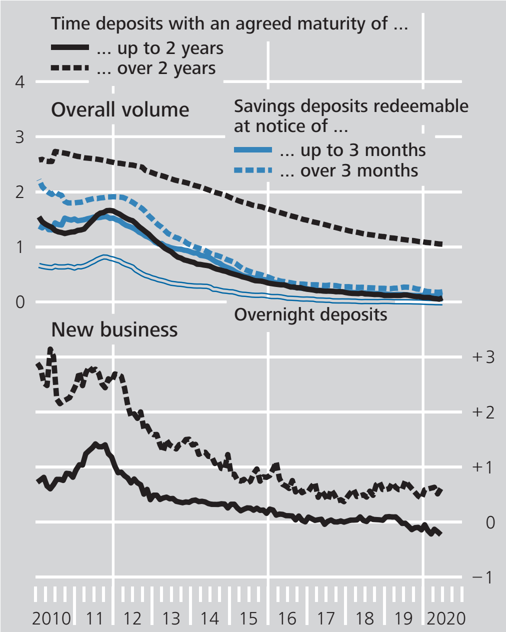
The largest net inflows in the reporting quarter were recorded by loans to non-financial corporations. Overall, growth was somewhat weaker than in the previous quarter, although this was solely attributable to short-term loans. These were cut substantially in the reporting period, which can largely be seen as a countermovement to the strong increase in the previous quarter that was driven by crisis-induced liquidity bottlenecks. By contrast, medium and long-term loans to non-financial corporations increased significantly more strongly in the reporting quarter than in the previous three-month period. This development can be attributed not least to the Federal Government's extensive coronavirus assistance loans and other funding programmes of state governments that enterprises can access via their principal banks. In addition, banks reported that, as of March, they increasingly granted principal repayment deferrals to their corporate customers, which viewed in isolation also increases net lending.

According to BLS, supply-side policy more restrictive overall

At the same time, the banks surveyed in the BLS made their lending policy in corporate banking more restrictive across all major economic sectors. This is a direct response to the economic consequences of the coronavirus crisis. For one thing, the proportion of banks tightening their credit standards was higher than the proportion of banks reporting an eas-

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	2020 Q1	2020 Q2
Deposits of domestic non-MFIs1		
Overnight	89.3	64.4
With an agreed maturity of		
up to 2 years	1.5	− 10.8
over 2 years	− 8.9	− 15.4
Redeemable at notice of		
up to 3 months	− 9.0	2.0
over 3 months	− 2.5	− 2.5
Lending		
to domestic general government		
Loans	3.1	0.3
Securities	6.1	6.7
to domestic enterprises and households		
Loans2	46.8	27.1
of which: to households3	20.9	14.1
to non-financial corporations4	19.1	15.7
Securities	− 1.1	− 2.7

* As well as banks (including building and loan associations, but excluding the Bundesbank), monetary financial institutions (MFIs) here also include money market funds. Data adjusted for statistical changes and revaluations. **1** Enterprises, households and general government excluding central government. **2** Adjusted for loan sales and securitisation. **3** Including non-profit institutions serving households. **4** Non-financial corporations and quasi-corporations.

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Developments in the real portfolio returns of households in Germany

Like in other countries, nominal interest rates in Germany remain at historically low levels. For the general public, this is mainly visible in the slim nominal rates paid on bank deposits, an asset class which traditionally accounts for a significant share of German households' financial assets. Over the last few years, interest rates on bank deposits have been close to 0%, which, taken in isolation, dampens the returns that households can generate on their financial assets.

Interest payments are the only source of income that bank deposits can generate, whereas income flows from other types of financial asset, such as shares, debt securities, investment fund shares and claims on insurance corporations, also depend on price effects. In addition to this, shares and investment funds that invest in equities commonly pay out dividends as well. Any attempt to calculate households' real total portfolio return needs to consider not just interest payments but these other components as well.

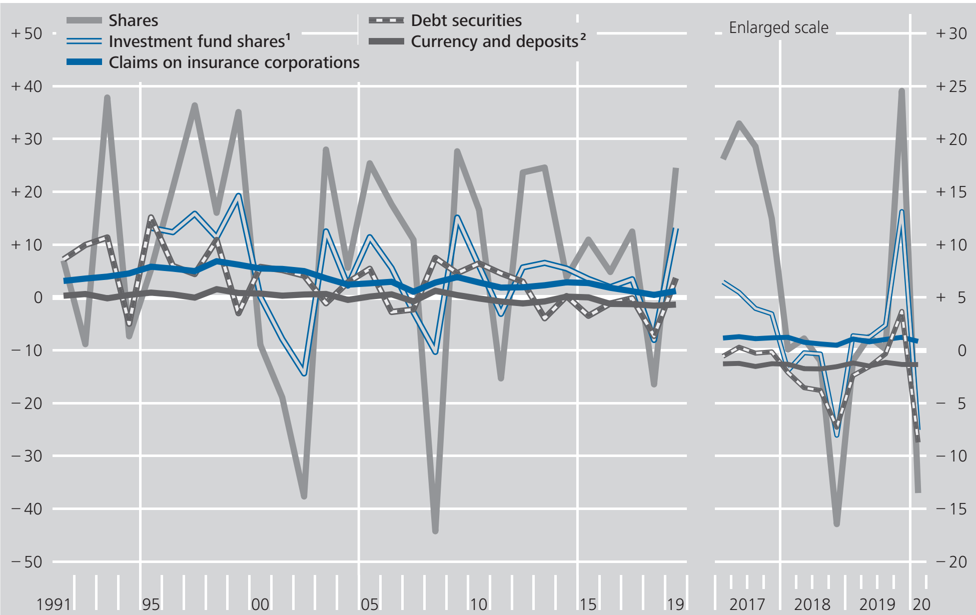
This box outlines how the returns on the various types of financial asset and the total return on households' financial assets in Germany have evolved up until the first quarter of 2020. Fluctuations in the purchasing power of nominal returns due to inflation are taken into account, so all returns are analysed in real terms.[1]

The chart below depicts the evolution of real returns on the main types of financial asset in the portfolio of households in Ger-

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*

Annual return at end of year/end of quarter, % p.a.



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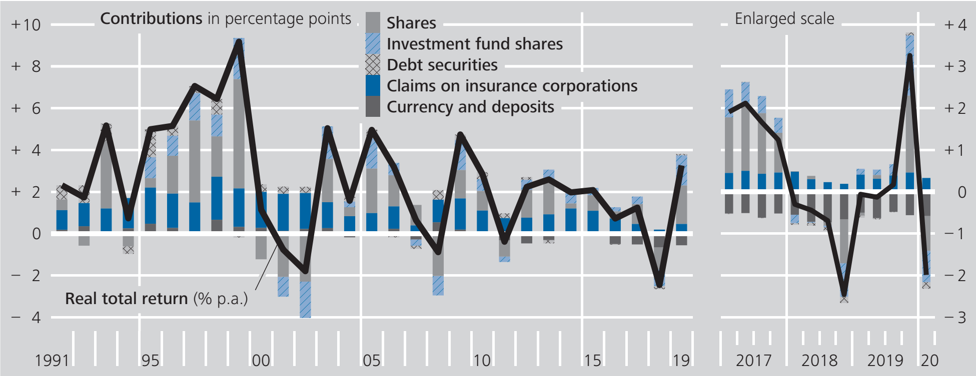
Contributions of individual types of financial asset* to the real total return of households in Germany

Annual return at end of year/end of quarter



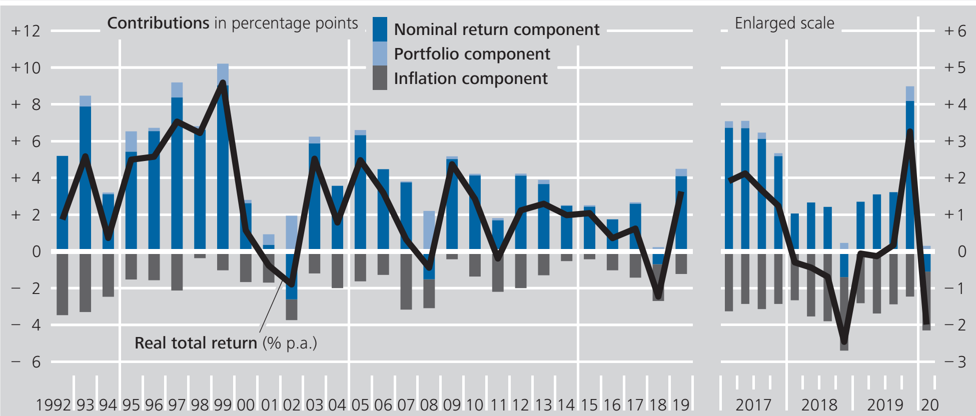
* Weighted according to share of total financial assets. Adjusted for inflation using the consumer price index (CPI).
Deutsche Bundesbank

many between 1991 and the first quarter of 2020.[2] Currency and deposits are the most important asset class in household portfolios, with a current share of around 40%. For much of the period, they have generally yielded a low real return that has also been relatively immune to volatility. While there have also been instances in the past when the real return dropped below zero, it has been mired deep in the red for quite some time now (since mid-2016). The situation is similar for debt securities, whose return has likewise been almost consistently negative in real terms since mid-2015, largely against the background of the Eurosystem's asset purchase programme (APP). As for insurance claims, a dwindling inflation rate helped the real return recover slightly from the historic low it recorded in 2018. Nonetheless, it remains at a low level. Rising capital market prices saw returns on shares and investment fund shares climb sharply up until the end of 2019. The positive stock market performance at the end of 2019 was probably down to a number of factors, including a handful of upbeat global eco-

2 The following is an updated version of the box from the August 2019 edition of the Bundesbank's Monthly Report; see Deutsche Bundesbank (2019).

Contributions to the real total return of households in Germany

Annual return at end of year/end of quarter



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nomic indicators and easing political uncertainty, as markets welcomed news that the UK general election had produced a clear majority and the United States and China had reached an initial trade agreement. Returns on shares and investment fund shares then fell sharply at the end of the first quarter of 2020, mainly because the COVID-19 pandemic and uncertainty surrounding its potential economic fallout sent capital market prices lower.[3]

The real total portfolio return (see the top chart on p. 41) is calculated on the basis of the structure of households' financial assets, which involves weighting the returns on the various asset types according to their share of the total portfolio and adjusting the figures for consumer price inflation. Thus calculated, the real total return is found to have risen from -0.1% to around 3.3% over the course of 2019. However, as securities prices floundered, especially in the light of the coronavirus pandemic, it fell at the beginning of 2020 and, at -2.0%, was clearly back in negative territory at the end of the period under review. This is its sharpest decline since the New Economy bubble burst.

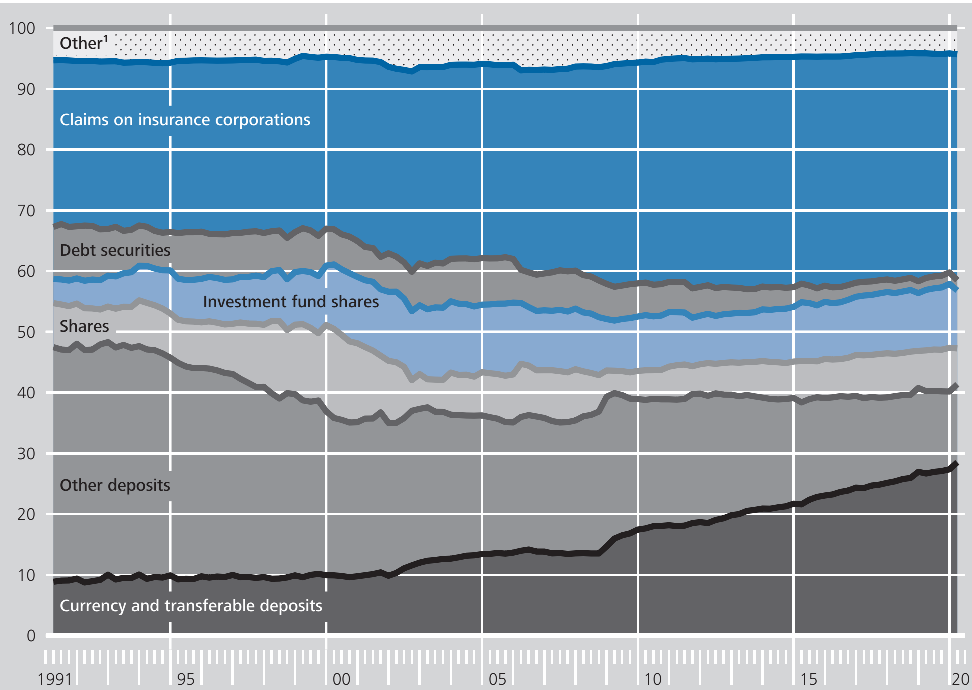
Viewed in multiyear terms, the contribution made by bank deposits, which has been persistently negative since the end of 2016, has consistently dragged down the real total return overall. The contribution made by securities returns, meanwhile, has been fairly volatile. While it weighed on the total return in the final quarter of 2018 and at the beginning of 2020 in particular, it was significantly positive at the end of 2019. The only positive contribution throughout – albeit a minor one – stemmed from claims on insurance corporations.

The real total return can be presented not just in terms of the different types of financial asset but also as a stylised breakdown

3 For more information about capital market developments in the first quarter of 2020, see Deutsche Bundesbank (2020a).

Structure of German households' financial assets

%, end-of-quarter data



1 Besides other accounts receivable, this also comprises other equity.
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by nominal return, portfolio and inflation component (see the bottom chart on p. 41). 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. 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 portfolio of financial assets; therefore, even if nominal returns and inflation rates remain constant, a shift into higher-yielding types of financial asset can boost the total return. Lastly, the inflation component stands for the contribution of the inflation rate (measured by the consumer price index, CPI).

The nominal return component was generally the key determinant of the real total return throughout the reporting period. While its contribution was mostly positive in recent years, it turned negative at the end of 2018 and at the beginning of 2020, mainly owing to bouts of sluggishness in capital markets. At the same time, the period under review saw the inflation component make a persistently negative contribution because the CPI has been hovering at positive rates of between 1.3% and 2.0% since 2017. By and large, the portfolio component had only a small impact on the total return. This is because the portfolio structure changes only gradually (see the chart on p. 42).[4] Overall, the aggregate rise in the nominal return component over the course of 2019 significantly boosted the real total return at first. However, the price slumps in the capital market triggered by the coronavirus pandemic pushed the real total return down to well below zero at the beginning of 2020.

4 For more information about changes in the structure of financial assets and developments in returns, see Deutsche Bundesbank (2020b).

ing of standards. In addition, the surveyed banks also made further restrictive adjustments to their credit terms and conditions. The main reason cited by surveyed bank managers for the tightening of the standards was their much less favourable assessment of the sector-specific or firm-specific situation as well as of borrowers' creditworthiness. In addition, the surveyed banks once again saw increased downside risks in terms of the general economic situation, the economic outlook and the recoverability of borrowers' collateral. The restrictive influence of these factors increased again compared with the previous quarter's survey, despite extensive government guarantees being provided through the special programme of the KfW. In addition, according to the banks, the cost of equity and funding conditions in the money and capital markets also had a restrictive effect on credit standards. The BLS banks are planning a further cross-sectoral tightening of their lending policies in the second half of the year.

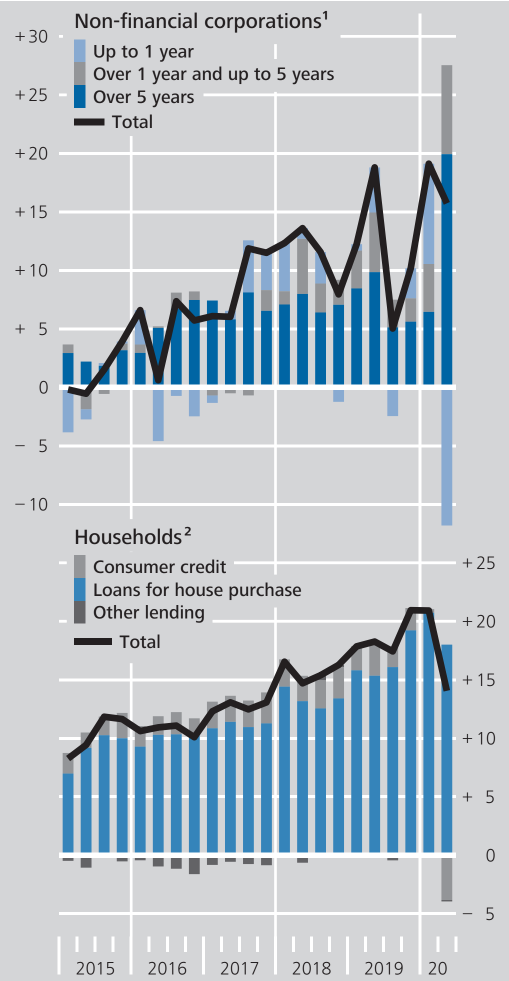
The tighter credit terms and conditions were reflected in a further expansion of margins, irrespective of credit ratings. Furthermore, credit institutions tightened their collateral requirements to a greater extent than at any point since the introduction of the BLS in 2003. For the first time in six years, a significant share of banks also increased their non-interest rate charges.

By contrast, interest rates on loans to enterprises remained low on aggregate, despite rising in individual sub-categories.[2] According to the MFI interest rate statistics, in the long-term maturity segment at the end of June, enterprises paid domestic banks 1.8% interest for small-scale loans and 1.3% for large-scale loans. Interest rates on short-term loans stood

2 Small-volume longer-term loans account for the bulk of the "KfW express loans 2020". These pandemic assistance loans to enterprises are priced at a relatively high interest rate of 3% and are likely to have been a key driver of interest rate developments in this credit segment.

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

€ billion, seasonally adjusted, three-month cumulated flows



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

at 1.9% and 1.2% respectively (see the chart on p. 45).

Further sharp increase in loans to households, driven exclusively by loans for house purchase

In addition to loans to non-financial corporations, loans to households also recorded perceptible net inflows in the reporting quarter. However, these were solely attributable to loans for house purchase, which, despite a downward movement at the end of the quarter, saw robust growth overall in the reporting quarter. On balance, the growth rate of loans for house purchase edged up once again, rising to 5.9% on the year.

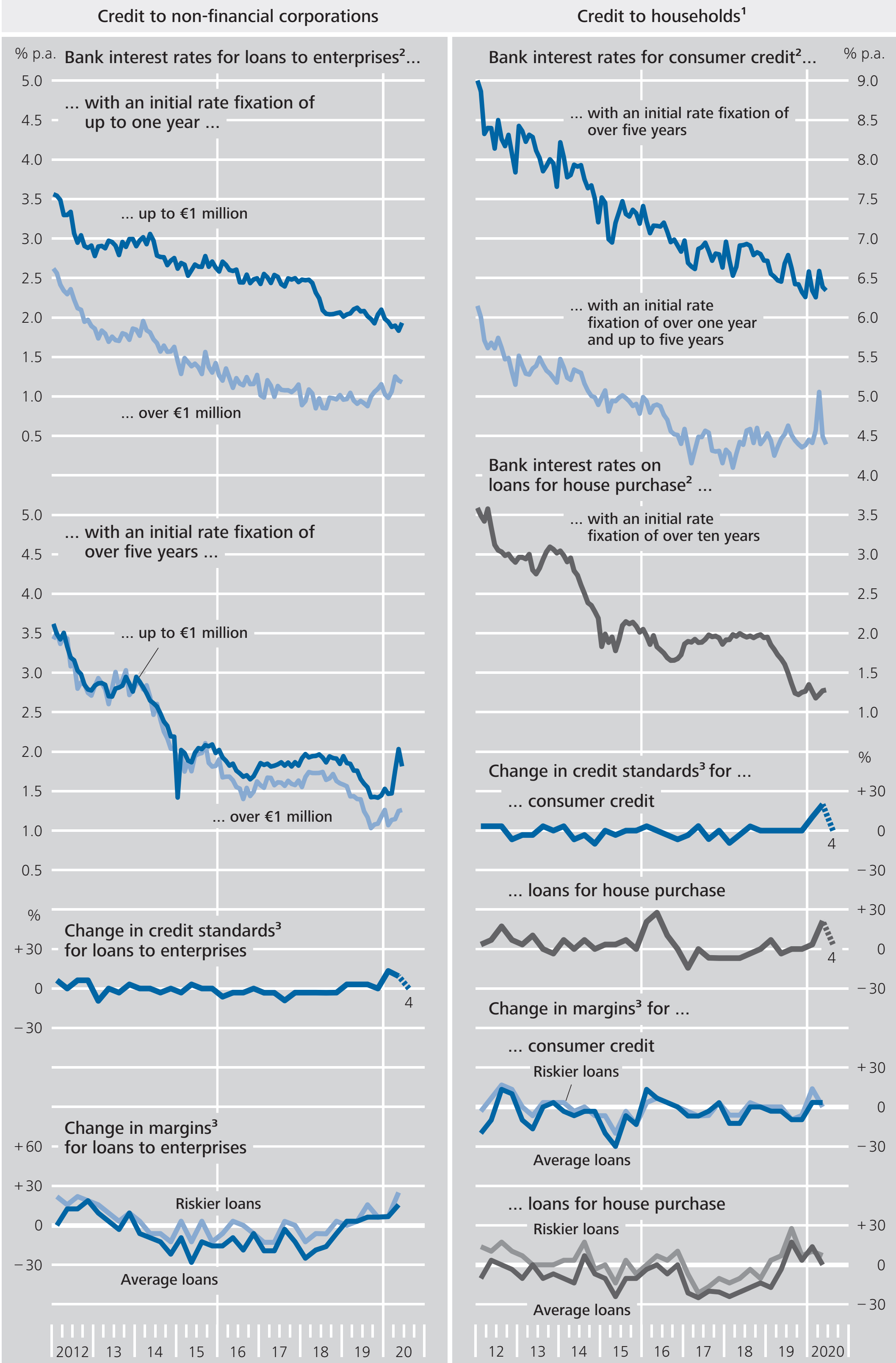
By contrast, the banks surveyed in the BLS reported a marked decline in demand for housing loans. One possible reason for this deviation is that BLS banks are asked to take into account all the information on demand developments available to them at the time. This includes not only the volume of signed loan agreements, but also newly received loan applications and loan requests. By contrast, MFI balance sheet statistics only cover agreed loan amounts that have already been paid out. In this respect, discrepancies may arise between these two data sources, especially in times of exceptionally strong movements and high uncertainty. It remains to be seen whether the weakening momentum in the BLS data will be reflected in actual lending in the coming months.

BLS banks cited a decline in consumer confidence due to the COVID-19 pandemic as by far the most important reason for the reported fall in demand. In addition, some banks attributed the decline in demand to bank branch closures while lockdown measures were in place. By contrast, when viewed in isolation, the outlook in the housing market and households' expectations of house price developments continued to provide positive stimuli for housing loan demand in the reporting quarter.

According to BLS, standards for housing loans also tightened

According to the BLS, credit standards for loans to households for house purchase were also tightened on balance in the second quarter of 2020. The effects of the coronavirus pandemic, which under the previous survey were not yet visible in the standards, have thus now led to a tightening in this credit segment as well. Banks also carried out more rigorous tightening of the credit terms and conditions in loan agreements, widening margins on riskier loans and reducing loan-to-value ratios. Here, too, institutions cited the deterioration in their assessment of credit risk and a lower risk tolerance as the main reasons for tightening credit standards and credit terms and conditions.

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 Q3 2020.

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Consumer credit scaled back as a consequence of the crisis

In contrast to loans for house purchase, banks recorded a marked (net) decline in consumer credit in the reporting quarter for the first time since the summer of 2012. This development was due in part to the considerable restrictions in many consumer-related services sectors resulting from the coronavirus pandemic. In addition, growing uncertainty about the income outlook dampened consumers' propensity to buy.[3] This is largely consistent with the BLS data.

According to BLS, credit supply policy for consumer loans again more restrictive

Viewed in isolation, supply-side policy also dampened consumer lending. For example, the banks surveyed in the BLS reported a further tightening of their credit standards in the second quarter in this segment as well. The net percentage of banks that tightened their standards reached levels last seen during the 2008-09 financial crisis and the 2010 sovereign debt crisis. In addition, the surveyed banks tightened their terms and conditions for consumer loans and other loans. This tightening manifested itself primarily in the form of stricter limits on loan amounts.

Deterioration in German banks' funding environment

Against the backdrop of the situation in the financial markets, in response to the ad hoc questions in the July BLS, German banks reported an overall deterioration in their funding situation compared with the previous quarter.

Impact of the NPL ratio on German banks' lending policy marginally restrictive in the first six months of 2020

According to banks, the share of non-performing loans in the gross book value of loans – i.e. the NPL ratio – contributed only marginally to a tightening of their lending policy in the first half of 2020. In the second half of the year, however, banks are anticipating a significantly more restrictive impact, especially with regard to loans to enterprises.

3 This is indicated by the GfK consumer climate index, which reached an all-time low in the reporting quarter.

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