Monetary policy and banking business

Monetary policy and money market developments

ECB Governing Council leaves key interest rates and purchase programmes unchanged

At its monetary policy meetings in September and October 2020, the ECB Governing Council left key interest rates and purchase programmes unchanged. The main refinancing rate remains at 0%, while the rate on the marginal lending facility stands at 0.25% and the deposit facility rate at -0.5%. Asset purchases under the pandemic emergency purchase programme (PEPP) will continue. As was decided in June, the envelope for these purchases will total €1,350 billion. The Governing Council will conduct net asset purchases under the PEPP until at least the end of June 2021 and, in any case, until it judges the coronavirus crisis phase to be over. The Governing Council will reinvest the principal payments from maturing securities purchased under the PEPP until at least the end of 2022. Net purchases and reinvestment under the asset purchase programme (APP) will also continue as hitherto.

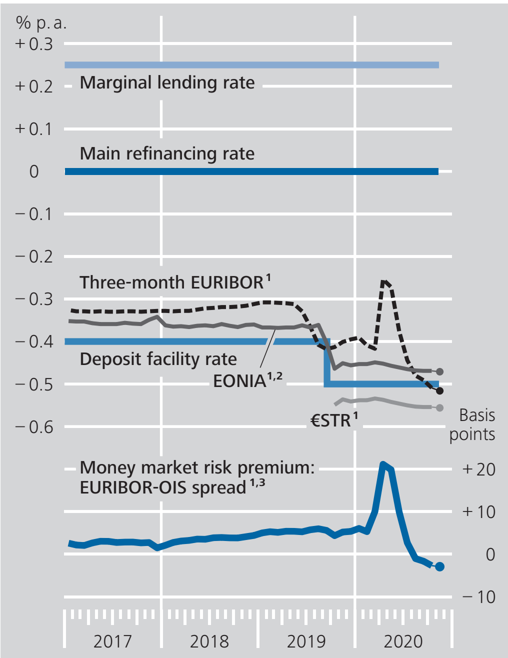
ECB Governing Council considers risks to be clearly tilted to the downside recently

The ECB Governing Council's initial assessment following its September meeting was that incoming data since July suggest a strong rebound in activity broadly in line with its previous expectations. However, the rise in new COVID-19 cases in many Member States weighed increasingly on the near-term outlook in October. Against this background, the ECB Governing Council considered risks to be clearly titled to the downside following its October meeting. The Governing Council communicated that it would carefully assess the incoming information over the subsequent weeks, including information on the dynamics of the pandemic, prospects for a rollout of vaccines, and developments in the exchange rate. In addition, the new round of Eurosystem staff macroeconomic projections in December will allow a thorough reassessment of the economic outlook and the balance of risks. Based on this updated assessment, the Governing Council will recalibrate its instruments, as appropriate, to respond to the unfolding situation and to ensure that financing conditions remain favourable. In doing so, the Governing Council aims to support the economic recovery and counteract the negative impact of the pandemic on the projected inflation path.

APP and PEPP continue to increase securities holdings recorded on balance sheet

APP holdings recorded on the balance sheet rose by €68.4 billion during the reporting period. On 6 November, the Eurosystem held assets totalling €2,872.7 billion as part of the APP (see the box on pp. 24 ff. for a breakdown of the holdings by individual programme). 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

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 12 November 2020.

Deutsche Bundesbank

Money market management and liquidity needs

In the two reserve maintenance periods under review running from 22 July 2020 to 3 November 2020, liquidity needs stemming from autonomous factors rose by €58.5 billion to €1,927.2 billion (see the table below).[1] This increase was mainly attributable to government deposits with the Eurosystem, which averaged €749.0 billion in the September-November 2020 reserve maintenance period and thus stood €77.8 billion above the average for the June-July 2020 period (see the chart on p. 25). A large part of this increase was due to higher deposits with the Bundesbank, which rose by €49.7 billion to €254.7 billion. The build-up of liquidity held by governments with central banks, which has been observed to a greater extent since the beginning of the coronavirus pandemic, thus continued. The higher volume of banknotes in circulation in the Eurosystem in the period under review also led to a growing need for liquidity. With an increase of €23.4 billion to an average of €1,389.1 billion in the September-November 2020 period compared with the June-July 2020 period, net demand for banknotes remained at a high level. €14.9 billion of this increase was attributable to cumulative net banknote issuance by the Bundesbank, which rose to €804.6 billion. By contrast, the rise in the combined total of net foreign assets and other factors, which are considered together owing to liquidity-neutral valuation effects, lowered liquidity needs by €42.7 billion. However, this change and also the above-mentioned

1 Average of the sixth reserve maintenance period of 2020 (September-November) compared with the average of the fourth reserve maintenance period of 2020 (June-July), which was covered in the August 2020 issue of the Monthly Report. This comparative approach is also used for the individual autonomous factors mentioned above.

Factors determining banks' liquidity*

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

Item	2020: 22 July to 15 September	2020: 16 September to 3 November
I. Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors		
1. Banknotes in circulation (increase: –)	– 15.5	– 7.9
2. Government deposits with the Eurosystem (increase: –)	– 41.7	– 36.1
3. Net foreign assets[1]	– 5.4	– 1.5
4. Other factors[1]	+ 52.1	– 2.5
Total	– 10.5	– 48.0
II. Monetary policy operations of the Eurosystem		
1. Open market operations		
a) Main refinancing operations	+ 0.5	+ 0.0
b) Longer-term refinancing operations	+ 191.7	+ 114.6
c) Other operations	+ 155.4	+ 152.2
2. Standing facilities		
a) Marginal lending facility	+ 0.0	+ 0.0
b) Deposit facility (increase: –)	– 57.2	– 47.5
Total	+ 290.4	+ 219.3
III. Change in credit institutions' current accounts (I. + II.)	+ 279.8	+ 171.3
IV. Change in the minimum reserve requirement (increase: –)	– 1.2	– 1.2

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

Deutsche Bundesbank

increase in government deposits were due in part to technical factors, because individual accounts were statistically reclassified. Over the reporting period, the minimum reserve requirement rose by €2.4 billion to €143.6 billion in the September-November 2020 reserve period and increased the need for central bank liquidity accordingly. In Germany, the reserve requirement went up by €0.7 billion to €39.5 billion.

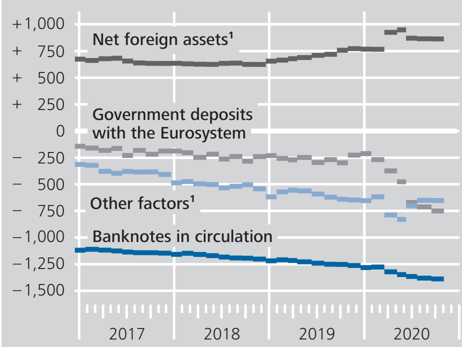
In the period under review, around one-third of central bank liquidity was provided by refinancing operations and two-thirds by purchase programmes with a focus on the pandemic emergency purchase programme (PEPP) (see the chart on p. 27). As a result of the attractive terms of the third series of targeted longer-term refinancing operations (TLTRO-III), the fifth TLTRO-III operation continued to see a relatively high volume of demand among banks, which took up a total of €174 billion. On balance, the fifth TLTRO-III operation as well as the maturities and repayments from TLTRO-II resulted in a net liquidity injection of €158 billion on 30 September 2020. Demand for pandemic emergency longer-term refinancing operations (PELTROs) remained only moderate for the third, fourth and fifth operations, totalling €7.5 billion. Interest in the regular main refinancing operations and three-month tenders remained low, partly owing to the more attractive terms of TLTRO-III. In Germany, the outstanding volume of longer-term operations – which include TLTROs, PELTROs and three-month tenders – rose significantly to €320 billion in the period under review, which represented an increase of €85 billion compared with the June-July 2020 period.

At an average of €3,476 billion, holdings of the asset purchase programmes in the September-November 2020 period were around €308 billion above the average for the June-July 2020 period (see the table above).

In net terms, there was a considerable increase in excess liquidity in the period under review. Whilst excess liquidity in the July-September 2020 period rose by €310 billion compared with the previous period, it increased by a further €243 billion to an average of €3,114 billion in the subsequent September-November 2020 period, although this was counteracted slightly by the increase in government deposits with central banks.

Autonomous factors in the Eurosystem*

€ billion, mean values for the relevant reserve maintenance period



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

Deutsche Bundesbank

Eurosystem purchase programmes

€ billion

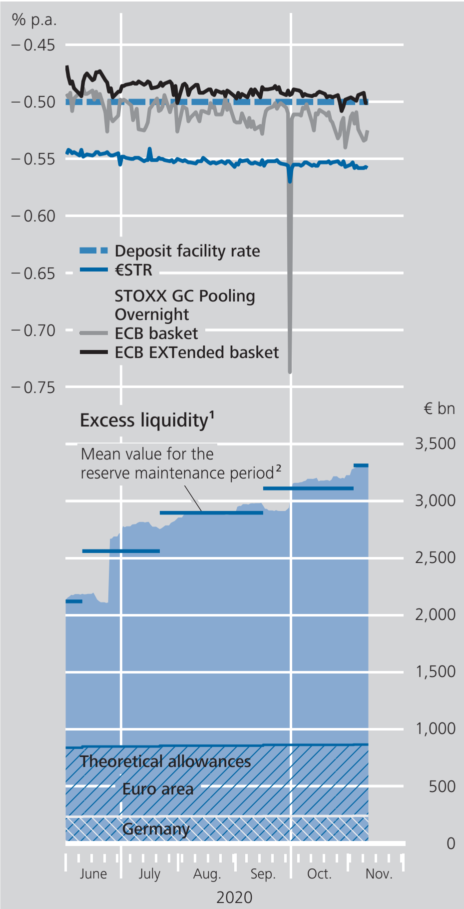
Programme	Change across the two reserve periods	Balance sheet holdings as at 6 November 2020
Active programmes[1]		
PSPP	+ 51.0	2,312.0
CBPP3	+ 0.9	286.2
CSPP	+ 19.9	245.1
ABSPP	− 0.9	29.4
PEPP	+ 223.2	641.6
Completed programmes		
SMP	− 6.0	28.6
CBPP1	− 0.0	0.5
CBPP2	− 0.1	2.8

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

Deutsche Bundesbank

Deposit facility rate, money market rates and excess liquidity

Daily data



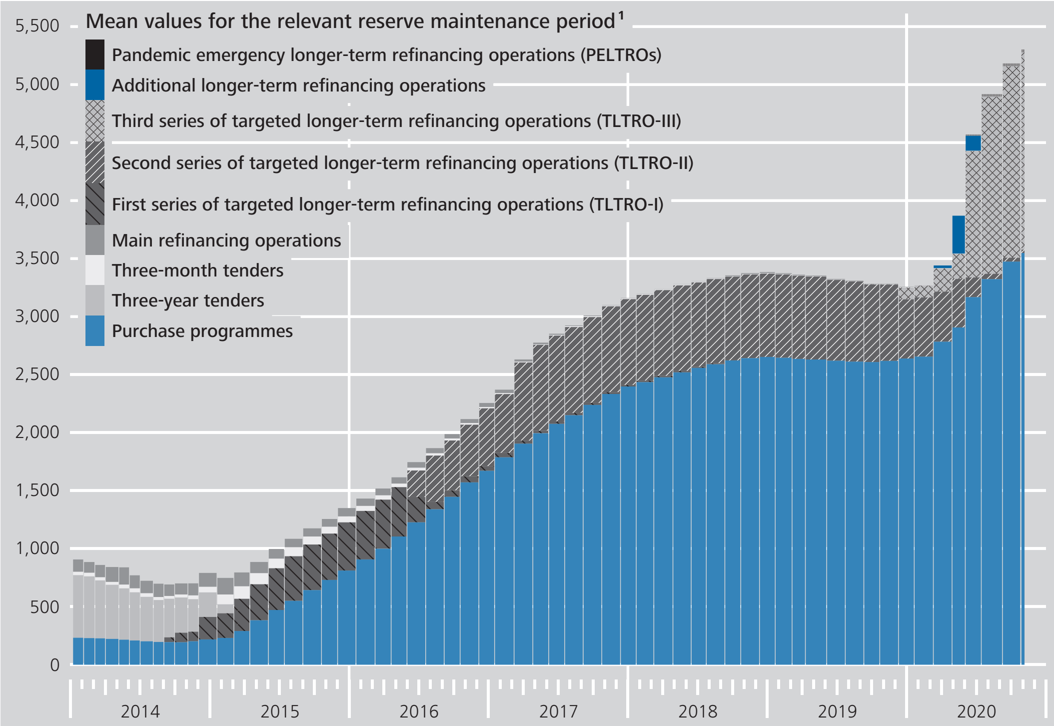
Sources: ECB, Eurex Repo and Bundesbank calculations. **1** Central bank balance minus the minimum reserve requirement plus the deposit facility. **2** The last period displayed is still ongoing.
Deutsche Bundesbank

At 98.8%, Eurosystem banks made somewhat greater use of the exemption allowances under the two-tier system for remunerating excess reserve holdings in the September-November 2020 period compared with the June-July 2020 period. In Germany, utilisation was still below the Eurosystem average, but also climbed more significantly to 98.4%. The increase in minimum reserve requirements caused the absolute exemption allowances to rise; however, given the much stronger growth in excess liquidity, excess reserves, remunerated at -0.50%, grew once again (see the chart above). This meant that, on average, around 28% of excess liquidity in the Eurosystem was exempted from remuneration at negative interest rates in the September-October 2020 period, compared with around 33% in the June-July 2020 period.

In the money market, interest rates fell somewhat 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 Eurex Repo's GC Pooling decline for the ECB basket, for the most part by 1 basis point to -0.51% to -0.52%, although there was a significant temporary decline to -0.74% with very low turnover at the end of the quarter in September 2020. While the rate for the ECB EXTended basket, which contains an extended pool of collateral, did not respond at this time, it also fell by around 1 basis point over the entire period under review to -0.49% to -0.50%. These developments should be seen in the context of declining turnover. For example, turnover on the GC Pooling platform for secured transactions with maturities of one day (ON, TN, SN; combined in the Deferred Funding Rate) fell by an average of around €5 billion in the September-November 2020 reserve period compared with the period preceding the period under review, to €5.9 billion per day. By comparison, there was little change in the €STR, which mostly stood at -0.55%, although it was at -0.56% on certain days towards the end of the period under review. €STR turnover, too, remained broadly stable, averaging just under €43 billion in the period under review, compared with €41 billion in the two previous reserve maintenance periods. However, the €STR volume increased to an average of just over €45 billion following the settlement of the fifth TLTRO-III operation until the end of the September-November 2020 period.

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.
Deutsche Bundesbank

cost accounting.[1] Securities holdings reported under the PEPP amounted to €641.6 billion on 6 November, up by €187.7 billion.

Fifth TLTRO-III sees relatively high demand

On 30 September 2020, the fifth operation of the third series of targeted longer-term refinancing operations (TLTRO-III) was settled, with 388 banks taking up a total of €174.5 billion. Although demand was considerably lower than it had been for the fourth operation, it still exceeded the expectations of market participants. The amended conditions for TLTRO-III operations proved to still be highly attractive for many counterparties, even though the September operation only offered banks the favourable interest rate of up to -1% for a period of just around nine months (as opposed to 12 months as in the June operation). By contrast, demand for pandemic emergency longer-term refinancing operations (PELTROs) remained subdued, with a total of just €7.5 billion being allotted across three operations from August to October.

Continued growth in excess liquidity

Continued net asset purchases and the allotment of TLTROs caused excess liquidity to grow further, albeit at a slower pace than in the previous reporting period. As this report went to press, the volume of excess liquidity stood at €3,308 billion, which corresponds to an increase of around €400 billion (see the box on pp. 24 ff.).

Short-term money market rates mixed

Short-term money market rates had a mixed showing 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), remained broadly unchanged overall at -0.47% for the most part. By contrast, the three-month EURIBOR posted yet another clear decline to end the period at -0.52%, which was significantly lower than EONIA, but still higher than €STR. The yield

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.

spread between the three-month EURIBOR and three-month EONIA swap rate, which is used as an indicator for money market risk, continued to narrow and is negative at present. This development is likely to be primarily attributable to the Eurosystem's comprehensive provision of liquidity. Liquidity developments contributed to changing supply and demand conditions in neighbouring market segments, which generally led to declines in interest rates. Due to the method of calculation, these declines in interest rates in other market segments can in turn have an impact on EURIBOR, too. By contrast, expectations of a reduction in the deposit facility rate within the next few months – which, in the past, had caused EURIBOR to temporarily drop below the level of EONIA at times – are not likely to have played any significant role (see the following section).

Money market forward rates markedly higher of late

Forward rates in the money market went into slight decline initially following the ECB Governing Council's monetary policy meeting in September. For a time, the lowest point of the curve stood at -0.62% for the third quarter of 2022. A reduction of 10 basis points in the Eurosystem deposit facility rate was factored into the forward rates for the third quarter of 2021. Rather than expectations of falling interest rates, it was probably an increase in negative term premia in light of heightened uncertainty over how the coronavirus pandemic will play out that was primarily behind the decline in forward rates for medium-term to longer-term maturities. However, after news of the latest advances in vaccine development was made public, forward rates rose considerably, leaving only a low probability of a reduction in the deposit facility rate priced into forward rates. As in previous months, the surveys conducted prior to the ECB Governing Council's monetary policy meetings in September and October provided hardly any indication of expectations that the deposit facility rate would be reduced: in median terms, survey participants once again reported that they did not expect the deposit facility rate to be lowered over the entire survey horizon.

Monetary developments in the euro area

Monetary dynamics still very fast-paced due to coronavirus pandemic

Monetary developments were again shaped by the coronavirus pandemic in the third quarter of 2020. The annual growth rate of the broad monetary aggregate M3 accelerated to 10.4% at the end of September, twice the rate observed at the end of December 2019. These current dynamics were driven by three factors. First, households and non-financial corporations continued to build up their holdings of highly liquid deposits in the reporting quarter. Precautionary considerations in light of the still intense uncertainty surrounding the future course of the pandemic were paramount in this regard. Second, the strong monetary growth continued to be fuelled by the Eurosystem's asset purchase programmes – especially the large-scale government bond purchases – which were expanded during the crisis. Third, commercial banks' lending to the domestic private sector once again made a substantial contribution to monetary growth. Although the economic recovery caused demand for loans among non-financial corporations to weaken compared to the two very strong preceding quarters, lending to the private sector as a whole during the reporting quarter was nevertheless slightly up on its level from before the outbreak of the coronavirus crisis.

Monetary inflows driven primarily by tendency in the private non-financial sector to build up liquidity buffers

On the components side, monetary growth in the third quarter was driven by overnight deposits, which – as had already been the case in the two preceding quarters – recorded extraordinarily strong increases as a result of precautionary considerations.[2] Households in particular once again added very substantially to their holdings of overnight deposits. The strong

2 Deposits on central governments' accounts with the Eurosystem also rose again sharply in the third quarter of 2020. Central governments are likely to have used these accounts to store some of the inflows from the securitised lending taken up to tackle the coronavirus crisis. These deposits do not form part of M3, as central governments are not included in the money-holding sector when calculating the monetary aggregates. Taken in isolation, the inflows to deposits therefore dampened monetary growth.

preference for liquidity was bolstered by the persistently low interest rate level and the associated low opportunity cost of holding highly liquid instruments, especially in relation to other forms of deposit. Continued brisk growth was also observed in the overnight deposits of non-financial corporations; compared with the extraordinarily strong inflows in the two preceding quarters, though, the figures suggest that these corporations were building up liquidity buffers to a more limited extent overall. The temporary lull in the pandemic situation and the subsequent reduction in uncertainty were also reflected in a gradual decline in currency demand in the money-holding sector, which had increased sharply in the first half of the year.

Slower expansion in lending to the private non-financial sector overall

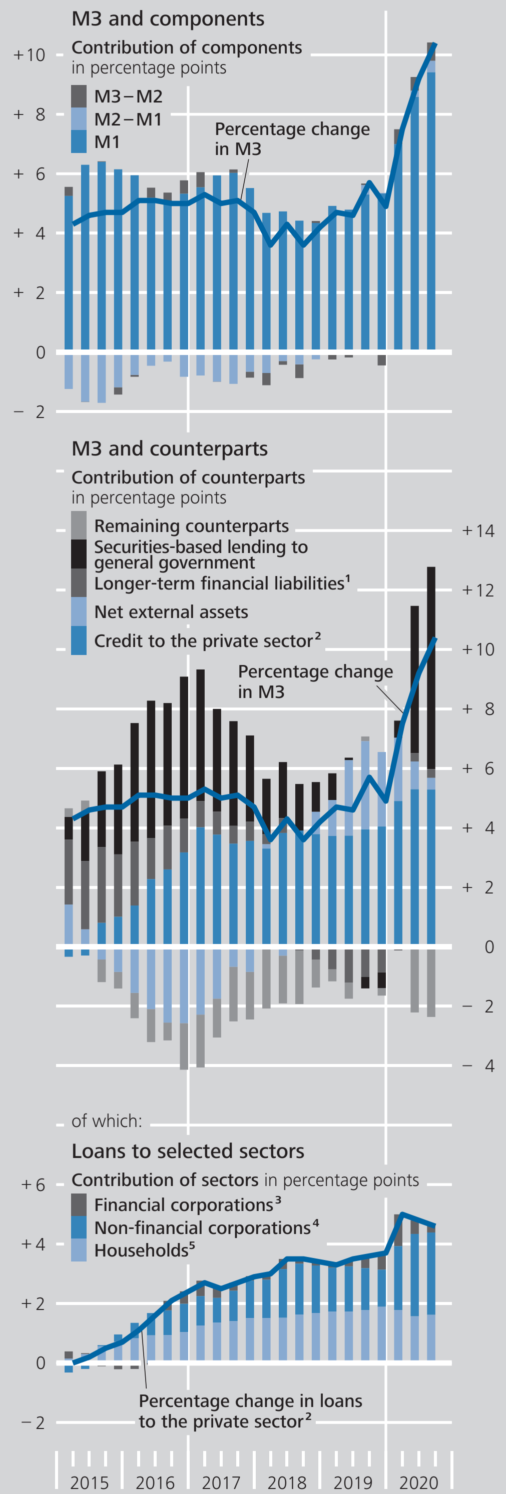
As for the counterparts, monetary growth in the third quarter of 2020 was driven chiefly by loans to domestic non-banks. Loans and securitised lending to the domestic private sector remained major factors. However, their growth rates were down on the two strong preceding quarters, not least because banks' loans to the private non-financial sector continued to return to more normal levels during the third quarter.

Significant recovery in loans to households

Loans to households continued the recovery that began in May. The reporting quarter saw growth return to its pre-crisis level, bouncing back from a significant decline in the first half of the year due to the lockdown and social distancing measures as well as the other economic restrictions implemented to contain the pandemic. The current growth was chiefly attributable to the very strong inflows to housing loans, which were granted by banks in Germany and France, in particular. As a result, the annual growth rate in housing loans continued to rise and came to 4.5% at the end of the quarter, the strongest rate since 2011. Consumer credit, which had recorded considerable net outflows from March to May, likewise returned to growth in the reporting quarter, albeit at a more moderate pace than before the coronavirus crisis. By contrast, other loans, which mainly comprise loans to self-employed

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.

Deutsche Bundesbank

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

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

Assets	Q2 2020	Q3 2020	Liabilities	Q2 2020	Q3 2020
Credit to private non-MFIs in the euro area	194.9	160.4	Holdings against central government[2]	263.0	73.0
Loans	102.5	102.0	Monetary aggregate M3	405.7	380.0
Loans, adjusted[1]	110.6	84.1	of which components:		
Securities	92.4	58.4	Currency in circulation and overnight deposits (M1)	365.6	322.8
Credit to general government in the euro area	507.1	244.3	Other short-term deposits (M2-M1)	42.5	33.5
Loans	− 1.7	− 4.0	Marketable instruments (M3-M2)	− 2.4	23.7
Securities	508.8	248.3	Longer-term financial liabilities	− 4.9	10.1
Net external assets	− 48.1	25.7	of which: Capital and reserves	16.9	8.2
Other counterparts of M3	10.0	32.8	Other longer-term financial liabilities	− 21.8	1.9

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

Deutsche Bundesbank

persons, saw hardly any growth in the third quarter.

BLS banks report growth in credit demand among households …

This picture is consistent with the findings of the Bank Lending Survey (BLS) for the third quarter, where the bank managers surveyed reported a considerable rise in demand for loans to households for house purchase in net terms after demand had slumped in the second quarter. Banks in the euro area stated that catch-up effects related to the coronavirus pandemic played a key role in the upturn in demand. They also singled out the low general interest rate level as well as the positive outlook in the housing market and prospective developments in real estate prices as major factors driving the increase in demand. In addition, the banks surveyed by the BLS also reported a marginal rise in demand for consumer credit and other loans, attributing this mainly to renewed but tentative customer interest in spending on consumer durables.

… while credit standards were tightened at the same time

On the supply side, the banks that responded to the BLS tightened their standards for housing loans more strongly than they had done in more than seven years for the second time in a row. This tightening of standards was generally comparable in scale with the banks' response during the sovereign debt crisis, but it was much less pronounced than the tightening that took place during the global financial crisis. The decisive factor for the adjustment of standards was the deteriorated assessment of credit risk, particularly of the general economic situation and outlook. Lower risk tolerance amongst institutions also led them to restrict their standards. Alongside these aspects, the banks explicitly stated that the coronavirus pandemic was a relevant factor for the tightening of standards. In addition, the surveyed institutions again tightened their standards for consumer credit and other loans, albeit to a lesser extent than in the previous quarter.

Decelerated growth in loans to non-financial corporations

Loans to non-financial corporations likewise saw a certain degree of normalisation in the third quarter of 2020 as the situation surrounding the pandemic improved and the economy posted a robust recovery. Following strong inflows in the first two quarters of the year, which had been characterised by the coronavirus crisis, third-quarter net inflows were only just slightly above their level from before the outbreak of the pandemic. These inflows were driven yet again by longer-term lending, which was supported by the take-up of government support measures. Annual growth in loans to non-financial corporations persisted at an increased rate of 7.1%.

In country terms, the net inflows to the euro area aggregate mainly originated from banks in France and Italy, on balance. While net inflows in France were at a high level but in decline, they were up on the quarter in Italy, probably because government assistance programmes there were implemented later in some cases. Conversely, banks in Germany and Spain reported limited net outflows, which were chiefly due to repayments of short-term loans. Two factors caused credit demand to soften in the reporting quarter. First, the strong economic recovery and the associated rebound in income reduced the acute liquidity needs of many enterprises. Second, with the pandemic situation beginning to improve in May, enterprises on the whole were largely able to use the funds they had raised from taking out loans and issuing bonds in the second quarter in net terms to build up liquidity buffers (see the upper chart on p. 32).

BLS banks report decline in credit demand amongst enterprises …

The bank managers interviewed as part of the BLS likewise reported that demand for loans among non-financial corporations had fallen slightly in the third quarter. Respondents mainly put the decreased need for funds down to enterprises' reluctance to engage in fixed investment, mergers, takeovers and restructuring as a result of the pandemic. By contrast, they reported that funding needs for inventories and working capital as well as for refinancing, debt restructuring and renegotiation had risen and indicated that government assistance programmes were bolstering demand. The banks surveyed for the BLS expect net demand to bounce back in the fourth quarter, especially from small and medium-sized enterprises and particularly for short-term loans.

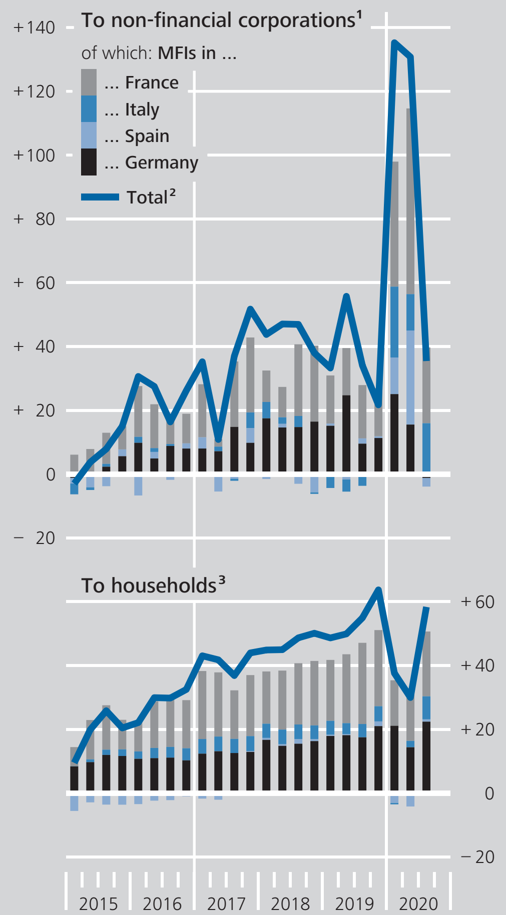
… and tighten their credit standards

While aggregate interest rates for corporate loans rose only marginally during the reporting quarter, the BLS offers evidence that banks significantly tightened their lending policy. Indeed, the surveyed banks reported overall that they had tightened their corporate credit standards in the third quarter of 2020 on a scale last seen in 2011. Asked to provide their main reasons for doing so, the banks pointed, first, to the increased risks on the borrower side and, second, to a deterioration in the general economic situation and outlook. Banks' lower risk tolerance was another factor that contributed to the tightening of standards. The reporting period also saw the surveyed banks tighten their credit terms and conditions, where their heightened risk sensitivity was reflected primarily in higher loan collateral requirements as well as in widened margins for riskier loans.

The MFI sector increased not only its loans but also its securities-based lending – especially in the form of bonds and debt securities – to the

MFI loans to the private non-financial sector in the euro area*

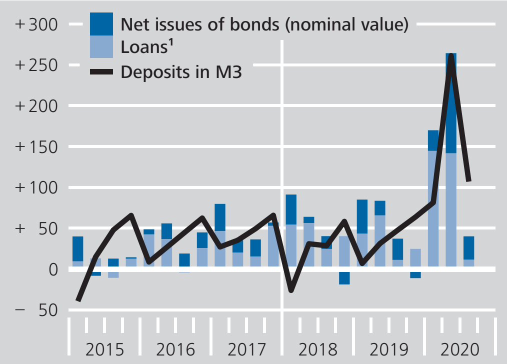
€ billion, 3-month accumulated flows, end-of-quarter data, seasonally adjusted



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

Borrowing and uses of funds by non-financial corporations* in the euro area

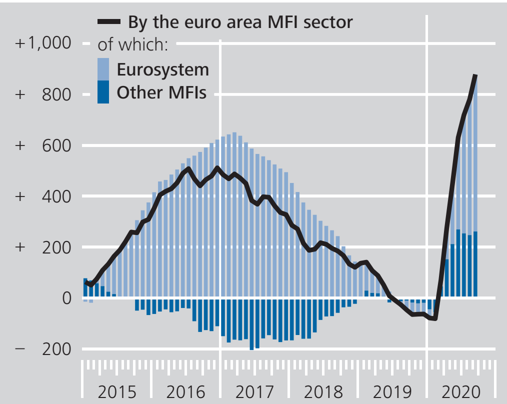
€ billion, 3-month accumulated flows, end-of-quarter data



* Non-financial corporations and quasi-corporations. 1 Adjusted for loan sales and securitisation as well as for positions arising from notional cash pooling services provided by MFIs.
Deutsche Bundesbank

Securities-based lending to general government in the euro area

€ billion, 12-month accumulated flows



Sources: ECB and Bundesbank calculations.
Deutsche Bundesbank

Securitised lending to domestic private sector posting considerable net inflows

domestic private sector significantly in the reporting quarter. Commercial banks, in particular, upped their holdings. The positive yield spread offered by these instruments over lower-risk alternative investments, such as in government bonds, is likely to have been an enticing feature. Yet the Eurosystem likewise showed meaningful demand for private debt securities as part of its asset purchase programmes (APP and PEPP) – which were expanded in March and June in response to the crisis.

MFIs' loans to general government rose far more rapidly than their lending to the private sector in the third quarter. It was especially securitised lending to government which did particularly much to support monetary growth. Although net inflows into government bonds were one-half the record level set in the previous quarter, they still remained extraordinarily high. The expansion was, on balance, solely due to the Eurosystem. For commercial banks, which had built up their holdings strongly in the preceding two quarters, government bonds lost some of their appeal as an investment product because their yields continued to fall in most euro area countries.

Securitised lending to government once again exceptionally high owing especially to monetary policy purchase programmes

Positive net impact on M3 from cross-border flows of goods and capital

In the reporting quarter, the net external asset position likewise supported monetary growth through moderate net inflows. According to the balance of payments data, which are not seasonally adjusted and currently available only for July and August, it was particularly the renewed increase in the current account surplus which impacted positively on the net external asset position. Moreover, the balance of cross-border securities transactions is likely to have lent some support, as non-residents were net purchasers of securities issued by residents, especially equities and investment fund shares, in July and again in August. Net purchases of foreign instruments by resident investors lagged behind. It was particularly resident investors' demand for long-term bonds issued by non-residents which fell over this period.

German banks' deposit and lending business with domestic customers

Renewed strong growth in deposit business

German banks' deposit business with domestic customers yet again posted strong growth in the third quarter of 2020, with domestic investors continuing to show an exceptionally strong preference for overnight bank deposits. It was particularly households, but also non-financial corporations, which once again amassed overnight deposits despite, in some cases, negative interest rates, though net inflows fell short of the previous quarter's record levels. On the other hand, short-term time deposits remunerating at close-to-market rates and all longer-term deposits continued their slide in the reporting quarter. This tendency is likely to have been fostered by the narrow yield spreads (see the adjacent chart).

All in all, the high level of uncertainty about the future of the pandemic and thus also the economic recovery path has encouraged households and non-financial corporations in Germany to increase their precautionary saving in recent months. This means that, since the beginning of the pandemic, these sectors have, on balance, built up a sizeable pool of liquidity reserves which they can tap into if their financial situation deteriorates.

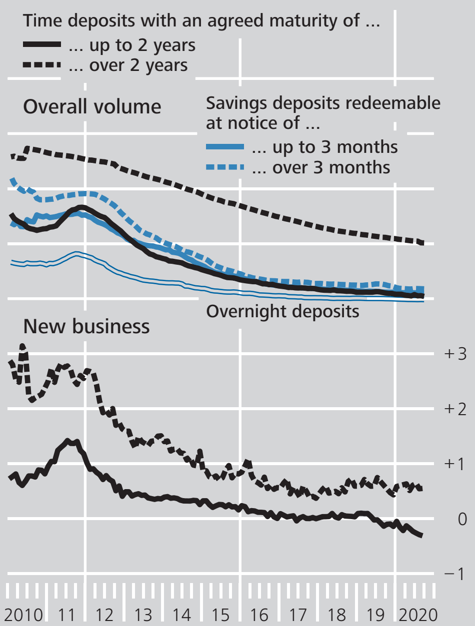
Lending business with non-banks weaker on balance

In the reporting quarter, banks' lending business with domestic customers grew at a perceptibly weaker pace than in the previous quarters. It should be taken into account, though, that growth of credit to domestic non-banks had been exceptionally strong in the two preceding quarters – under the spell of the crisis and government assistance measures. Seen in that light, the current development is a reversion to more normal levels. Whereas lending business with the domestic private sector continued to grow moderately, German banks perceptibly cut back their lending to domestic general government. They reduced, in particular, their holdings of securities issued by the domestic public sector after having expanded them considerably in the two preceding quarters. The very low yields on German government bonds across the board, which fell again a little in the reporting quarter, were probably a key reason for the waning interest. On the other hand, banks markedly increased their holdings of securities issued by the private sector, acquiring mainly bonds issued by non-financial corporations. Here, too, yield considerations will probably have been a primary motivating factor.

Banks saw the strongest net growth in lending to households, whose demand for loans for

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.

Deutsche Bundesbank

MFI* lending and deposits in Germany

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

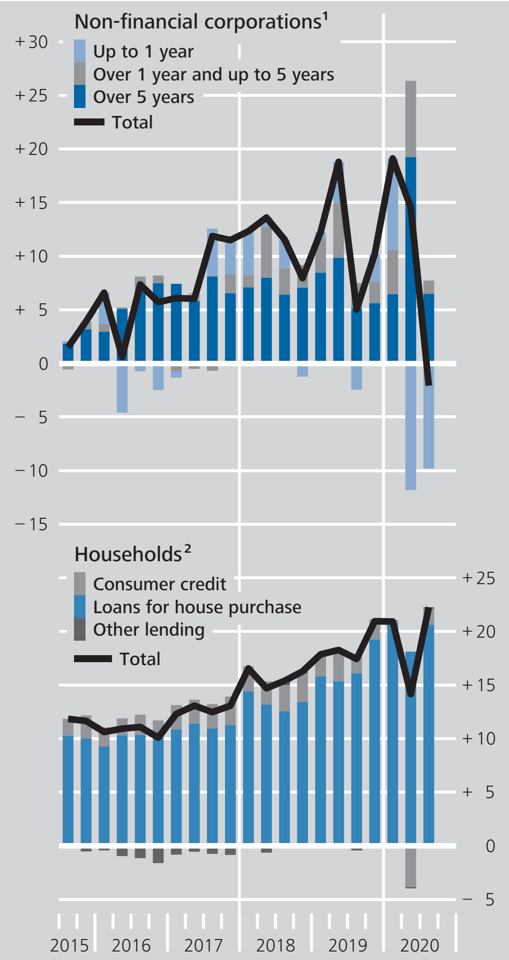
Item	2020 Q2	2020 Q3
Deposits of domestic non-MFIs[1]		
Overnight	64.3	67.9
With an agreed maturity of		
up to 2 years	– 8.9	– 4.1
over 2 years	– 15.4	– 9.2
Redeemable at notice of		
up to 3 months	2.0	0.3
over 3 months	– 2.5	– 1.3
Lending		
to domestic general government		
Loans	0.3	– 1.8
Securities	6.7	– 6.5
to domestic enterprises and households		
Loans[2]	27.4	19.6
of which: to households[3]	14.1	22.3
to non-financial corporations[4]	14.5	– 2.1
Securities	– 2.7	3.6

* 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.

Deutsche Bundesbank

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

€ billion, three-month accumulated flows, 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.
Deutsche Bundesbank

Growth dynamics of loans to households stable

house purchase remained high, consistent with the comparatively robust state of construction activity. Remarkably, the pandemic and its economic fallout do not appear so far to have had much, if any, impact on demand for residential property. Households were not only eyeing loans for house purchase but also displayed a certain renewed interest in consumer credit during the period under review, which, having been scaled back considerably in the previous quarter, was once again stepped up distinctly. All in all, the dynamics of loans to households in Germany have remained very stable, with the 12-month growth rate of loans to households coming in at 4.5% at the end of the reporting quarter, up slightly on its end-2019 level of 4.4%.

Sound household asset situation supporting credit demand

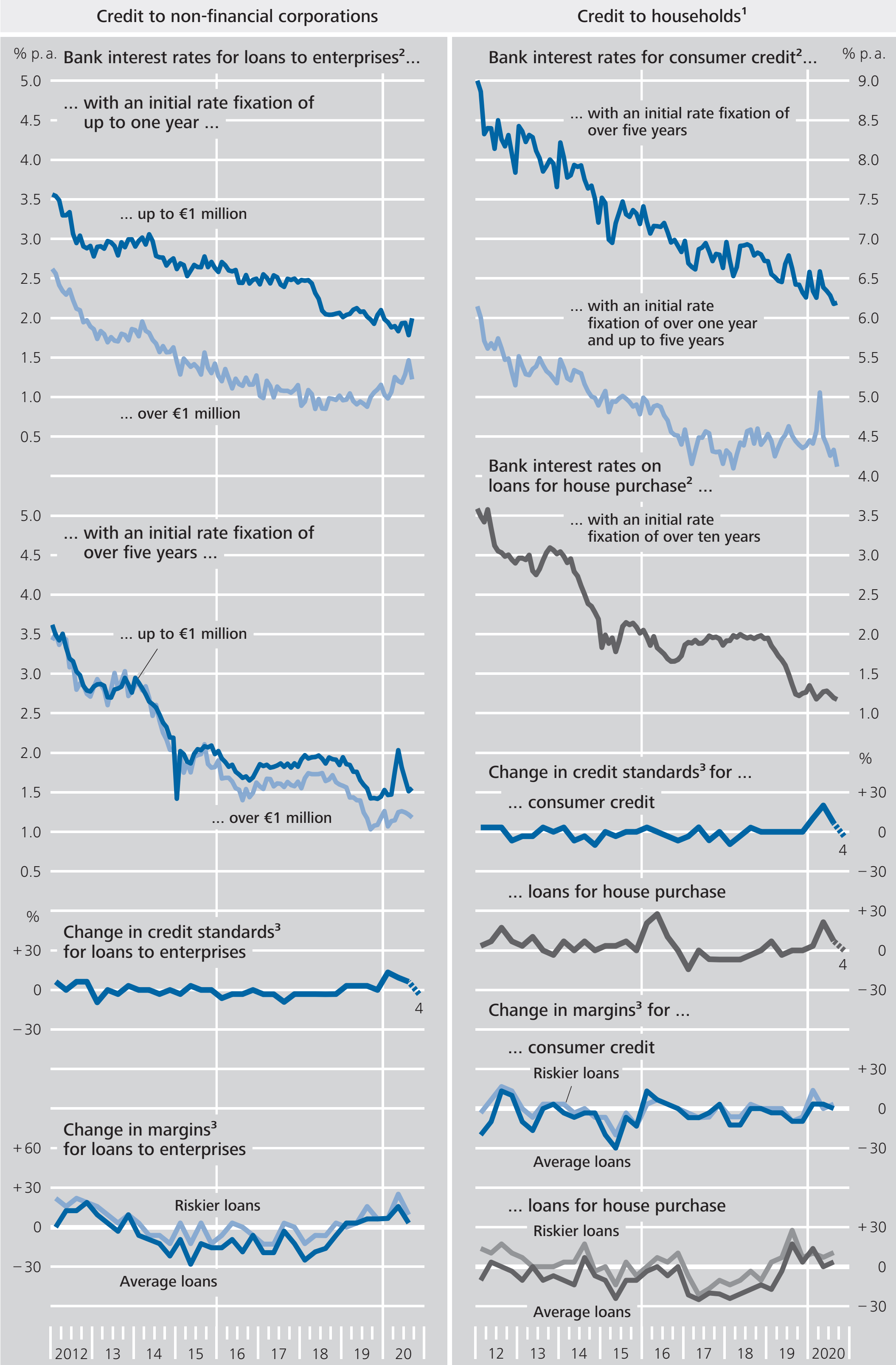
Demand for loans for house purchase and consumer credit in the third quarter was supported not only by signs of recovery in the labour market but also by the persistently very sound asset situation of households in Germany. The latest BLS suggests that other factors were at play as well. Besides the low general level of interest rates, another key reason cited by the banks for the increase in demand for housing loans was the positive outlook regarding the housing market and the house price developments expected by households. According to the banks, pandemic-related income losses as a result of, for instance, short-time working arrangements had less of an impact than initially feared.

Lending policy once again tightened somewhat according to BLS

Funding conditions have remained favourable. According to the MFI interest rate statistics, the interest rate on long-term loans for house purchase fell once again slightly in the reporting quarter, hitting a new all-time low of 1.2% at the end of the quarter. At the same time, the banks participating in the BLS reported tightening their credit standards and credit terms and conditions for housing loans once again in the third quarter. However, the net share of banks reporting tightening was down considerably from the previous quarter. The tightening of credit terms and conditions was reflected primarily in a widening of margins on riskier loans and a reduction in loan-to-value ratios. Institutions chiefly cited the deterioration in their assessment of credit risk and a lower risk tolerance as the main reasons for tightening the standards and terms and conditions for loans to households for house purchase. The banks likewise tightened their credit standards for consumer credit and other loans. Conditions in this credit segment remained broadly unchanged.

Loans to non-financial corporations, on the other hand, were down slightly on balance in the reporting quarter from the strong growth they had shown in the two preceding quarters.

Banking conditions in Germany



1 Including non-profit institutions serving households. **2** New business. According to the harmonised MFI interest rate statistics. **3** According to the Bank Lending Survey; for credit standards: difference between the number of respondents reporting "tightened considerably" and "tightened somewhat" and the number of respondents reporting "eased somewhat" and "eased considerably" as a percentage of the responses given; for margins: difference between the number of respondents reporting "widened considerably" and "widened somewhat" and the number of respondents reporting "narrowed somewhat" and "narrowed considerably" as a percentage of the responses given. **4** Expectations for Q4 2020.

Deutsche Bundesbank

Lending to enterprises down slightly on balance, especially owing to net redemptions of short-term loans

This decline was due to substantial net redemptions of short-term loans, whereas long-term loans once again picked up markedly. Their growth, however, fell well short of the strikingly strong previous quarter and was unable to make up for the sharp drop in short-term lending. However, this is not at odds with the brisk investment activity as, in the second quarter, enterprises had taken on large volumes of debt and built up generous liquidity reserves. They were then able to use these funds, together with the rebound in income, to finance investment and pay back short-term loans.

The banks surveyed in the BLS did, however, report a resurgence of demand for loans, especially among small and medium-sized enterprises. These enterprises are likely to be primarily from sectors that were hit especially hard by the pandemic. Consistent with this picture, business surveys are showing growing heterogeneity in the financial situation of enterprises in Germany.

Interest rates on loans to enterprises still near all-time lows

Current credit growth was supported ceteris paribus by the persistently low interest rates, with enterprises paying only slightly higher interest rates on small-scale loans (2.0%) and the same low rate of interest on large-scale loans (1.2%) in the short-term segment. Interest rates on longer-term loans fell slightly and, at the end of September, stood at 1.6% (previous quarter: 1.8%) and 1.2% (previous quarter: 1.3%), respectively.

Lending policy once again tightened somewhat according to BLS

On the other hand, the banks once again turned the screws on their lending policy somewhat in the quarter under review. According to the BLS results, the surveyed institutions continued to tighten their standards for loans to enterprises on balance, albeit considerably less severely of late than in the preceding quarter. As already in the previous quarter, the reasons cited by the institutions for tightening standards related primarily to a deteriorated assessment of the industry or firm-specific situation and of borrowers' creditworthiness. The banks tightened not only credit standards but also credit conditions. This was reflected, for one thing, in a widening of margins for riskier loans. For another, credit institutions tightened their collateral requirements for the third survey round in succession. Banks also imposed stricter limits on credit amounts than in the previous quarter.

Improvement in German banks' funding environment …

Against the backdrop of the situation in the financial markets, in response to the ad hoc questions in the October BLS, the surveyed German banks reported an overall improvement in their funding situation compared with the previous quarter. Funding through debt securities, in particular, improved in all maturity segments.

… through purchase programmes, amongst other things

Banks reported that the Eurosystem purchase programmes had, over the past six months, helped improve their liquidity position and funding conditions in the market. However, these programmes' impact on net interest income continued to weigh on banks' profitability. In the view of the surveyed banks, it was only in the area of loans to households for house purchase where the programmes made a sizeable contribution to credit growth.

Two-tier system for excess liquidity counteracting burden on banks imposed by negative interest rate

The negative interest rate on the deposit facility once again weighed on the net interest income of the banks surveyed as part of the BLS. The interest rate-reducing impact on lending rates was more pronounced than the effect on deposit rates. Banks reported that the negative interest rate enhanced volumes significantly only in the case of loans to enterprises. The negative earnings effect was tempered by the two-tier system for remunerating excess liquidity holdings, however.

Heightened interest in TLTRO-III thanks to attractive conditions

Twenty-four banks from the German BLS sample participated in the TLTRO-III operation in June 2020, and 14 in the September 2020 operation. The last two operations thus encountered greater interest on the part of banks than the previous operations. Participation in the June and September TLTRO-III operations was motivated primarily by their attractive design.

Funds mainly used for lending, substitution of TLTRO-II funds and liquidity holding in the Eurosystem

The banks reported using the uptake in funds primarily for lending to the non-financial sector, the substitution of TLTRO-II funds and liquidity holding in the Eurosystem. The surveyed banks reported that they intended to participate in future operations again mainly because of the TLTRO-III operations' attractive design. The TLTRO-III operations had barely any impact on banks' lending policies.