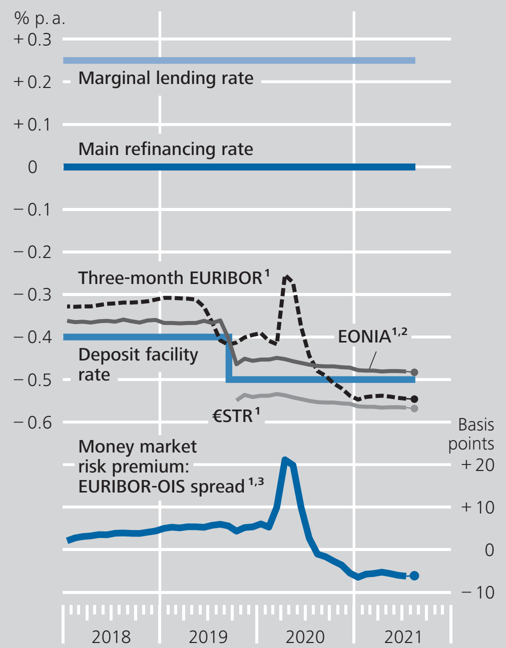
Monetary policy and banking business

Monetary policy and money market developments

ECB Governing Council expects higher monthly net purchases under PEPP to continue in third quarter

In June 2021, based on a joint assessment of financing conditions and the inflation outlook, the Governing Council of the ECB expected that net purchases under the pandemic emergency purchase programme (PEPP) would continue to be conducted over the third quarter at a significantly faster pace than during the first months of the year. Net asset purchases will continue with an unchanged total envelope of €1,850 billion until at least the end of March 2022 and, in any case, until the Governing Council judges that the coronavirus crisis phase is over. If favourable financing conditions can be maintained with lower overall purchase volumes, the envelope of €1,850 billion need not be used in full. Equally, the total envelope can also be increased if necessary. The Governing Council left the asset purchase programme (APP) and the key interest rates unchanged. Net purchases under the APP will continue at a pace of €20 billion per month. 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%.

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 of 1 to 19 August 2021.

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Maintaining favourable financing conditions remains essential

The new Eurosystem staff macroeconomic projections published in June indicate that underlying inflation pressures will gradually pick up over the entire projection horizon until the end of 2023. Given that there is still considerable economic slack that is only gradually being taken up, however, this pressure is set to remain subdued, though the ECB Governing Council has discussed a number of upside risks. Nevertheless, in the baseline scenario, headline inflation remains short of the Governing Council's target through to the end of the projection horizon. The Governing Council therefore continues to consider it essential to maintain favourable financing conditions for enterprises and households. These conditions have remained largely unchanged since the monetary policy meeting of March 2021, though market interest rates continued to rise. Although partly an expression of an improved economic outlook, the Governing Council believes a sustained rise in market interest rates could lead to a deterioration in financing conditions in the broader sense, which are important for the economy as a whole.

ECB Governing Council announces outcome of strategy review

In July, following the conclusion of its strategy review, the ECB Governing Council adopted its new monetary policy strategy. One of the key outcomes of the strategy review was a change to the inflation target.[1] The Governing Council considers that price stability is best maintained by aiming for a 2% inflation target over the

1 For the ECB Governing Council's statement on the monetary policy strategy, including more precise details and information on additional results of the strategy review, see European Central Bank (2021).

Money market management and liquidity needs

Between the March-April 2021 reserve maintenance period and the June-July 2021 reserve maintenance period, liquidity needs stemming from autonomous factors saw a strong rise of €142.0 billion to €2,050.8 billion (see the table below).[1] This was chiefly attributable to another significant uptick in the volume of banknotes in circulation in the Eurosystem, which increased by €38.1 billion to €1,485.8 billion. Of this, Germany accounted for a rise of €10.3 billion, putting cumulative net banknote issuance at €847.8 billion. Cash demand probably remained brisk due to the ongoing pandemic and the negative interest rate environment. Government deposits with the Eurosystem rose slightly by an average of €7.8 billion, reaching €652.3 billion on average in the June-July 2021 reserve maintenance period (see the chart on p. 30). This figure includes €206.8 billion in deposits with the Bundesbank. The combined total of net foreign assets and other factors, which are considered together owing to liquidity-neutral valuation effects, also had a liquidity-absorbing effect, declining by €96.1 billion on aggregate mainly because of an increase in non-monetary policy deposits such as deposits by foreign central banks. Over the reporting period, the minimum reserve requirement climbed by €2.0 billion to €149.3 billion in the June-July 2021 reserve period, which led to an additional need for central bank liquidity. In Germany the reserve requirement went up by €0.5 billion to €41.3 billion.

In the period under review, additional central bank liquidity was provided both by purchase programmes – in particular the pandemic emergency purchase programme (PEPP) – and by refinancing operations (see the chart on p. 32). Bids in the eighth operation of the

1 Average of the fourth reserve maintenance period of 2021 (June-July 2021) as compared to the average of the second reserve maintenance period of 2021 (March-April 2021), which was covered in the May 2021 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	2021 28 Apr. to 15 June	2021 16 June to 27 July
I. Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors		
1. Banknotes in circulation (increase: –)	– 18.1	– 20.0
2. Government deposits with the Eurosystem (increase: –)	+ 57.8	– 65.6
3. Net foreign assets[1]	– 6.9	+ 11.9
4. Other factors[1]	– 25.7	– 75.4
Total	+ 7.1	– 149.1
II. Monetary policy operations of the Eurosystem		
1. Open market operations		
a) Main refinancing operations	– 0.1	– 0.1
b) Longer-term refinancing operations	+ 52.4	+ 89.0
c) Other operations	+ 141.3	+ 151.8
2. Standing facilities		
a) Marginal lending facility	+ 0.0	+ 0.0
b) Deposit facility (increase: –)	– 30.1	– 30.1
Total	+ 163.5	+ 210.6
III. Change in credit institutions' current accounts (I. + II.)	+ 170.6	+ 61.4
IV. Change in the minimum reserve requirement (increase: –)	– 0.4	– 1.6

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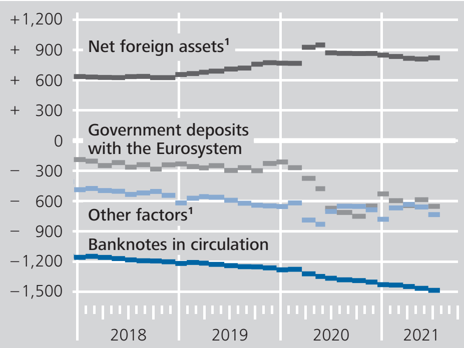
Autonomous factors in the Eurosystem*

€ 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.
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Eurosystem purchase programmes

€ billion

Programme	Change across the two reserve periods	Balance sheet holdings as at 13 Aug. 2021
Active programmes[1]		
PSPP	+ 44.6	2,437.3
CBPP3	+ 4.4	294.5
CSPP	+ 16.1	289.3
ABSPP	− 0.1	28.4
PEPP	+ 255.3	1,296.9
Completed programmes		
SMP	− 6.4	14.7
CBPP1	0.0	0.4
CBPP2	+ 0.0	2.4

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

third series of targeted longer-term refinancing operations (TLTRO-III) in June were relatively high at €109.8 billion, despite the remaining period subject to attractive special interest rate conditions of as low as -1.0% being three months shorter than in the seventh TLTRO-III in March 2021 (which reached €330.5 billion). At €0.5 billion in total, there was hardly any demand for the ninth pandemic emergency longer-term refinancing operation (PELTRO) in June (previous operation in March 2021: €0.4 billion). Uptake of the regular main refinancing operations and three-month tenders likewise remained very subdued. Total tender volume in the Eurosystem amounted to an average of €2,196 billion in the June-July 2021 period. In Germany, the outstanding volume of longer-term operations – which include TLTROs, PELTROs and three-month tenders – rose by €27.0 billion to an average of €434.3 billion in the period under review, which represented a share of around 20% of the outstanding volume of long-term tenders in the Eurosystem, just as it did in the previous period under review.

At an average of €4,244.5 billion, balance sheet holdings of the asset purchase programmes in the June-July 2021 period were around €293.0 billion above the average for the period under comparison (see the adjacent table).

Excess liquidity rose by a net €290.3 billion overall in the period under review to €4,240.3 billion on average, increasing by €200.4 billion in the April-June 2021 period and again by €89.9 billion in the subsequent June-July 2021 period. The stronger increase in the first period was primarily a result of the marked drop in government deposits with the Eurosystem observed initially in this period, which had a liquidity-providing effect on this autonomous factor.

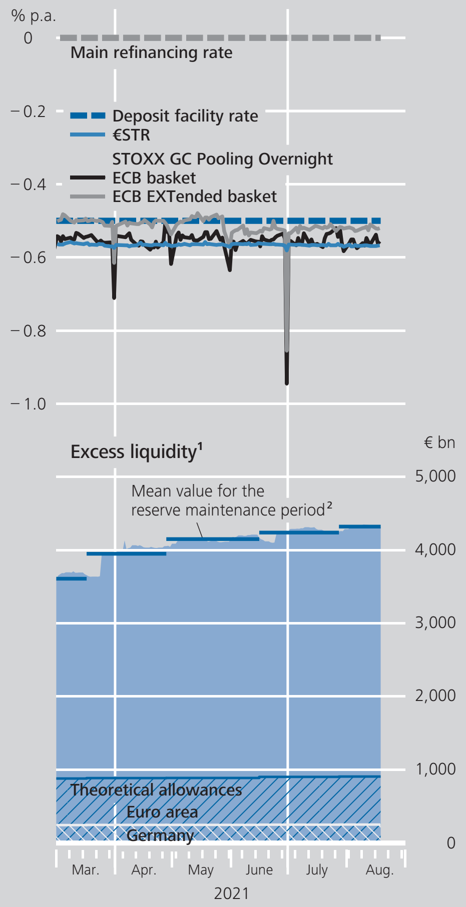
At 99.3%, Eurosystem banks made slightly greater use of the exemption allowances under the two-tier system for remunerating excess reserve holdings in the June-July 2021 period than in the March-April 2021 period (99.1%). In Germany, utilisation of the exemption allowances was very close to the Eurosystem average at 99.2%. The increase in the minimum reserve requirement caused absolute exemption allowances to rise; however, given the stronger growth in excess liquidity, excess reserves remunerated at -0.50% grew once again (see the chart on p. 31). This meant that, on average, 21.1% of excess liquidity in the Eurosystem was exempted from remuneration at negative interest rates in the June-July 2021 period, compared with 22.4% in the March-April 2021 period (in Germany: 20.5% and 20.9%, respectively).

The secured money market saw interest rates drop slightly during the period under review.

Including the outliers at the end of the first quarter and the half-year period, which were somewhat larger in June than in March, overnight rates in the secured market in GC Pooling fell by 0.7 basis point for the ECB basket and 1.5 basis points for the ECB EXTended basket. This resulted in average rates of -0.56% and -0.52%, respectively (see the adjacent chart), though rates did dip to -0.95% and -0.86%, respectively, at the end of the half-year period in June 2021. The somewhat stronger decline in rates for the ECB EXTended basket left the spread between the two rates at 4 basis points on average, compared with 5 in the preceding period under review. The backdrop to this was a reduction in turnover on the GC Pooling platform for secured transactions with maturities of one day (ON, TN, SN; combined in the Deferred Funding Rate). This turnover fell to €5.5 billion in the current period under review, down from an average of €7.6 billion in the preceding period under review. The unsecured euro short-term rate (€STR) remained almost unchanged for the most part at -0.57%. €STR turnover also stayed broadly stable, averaging €44 billion in the period under review, though it did pick up somewhat after the allotment of the TLTRO-III in June.

Central bank interest rates, 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.

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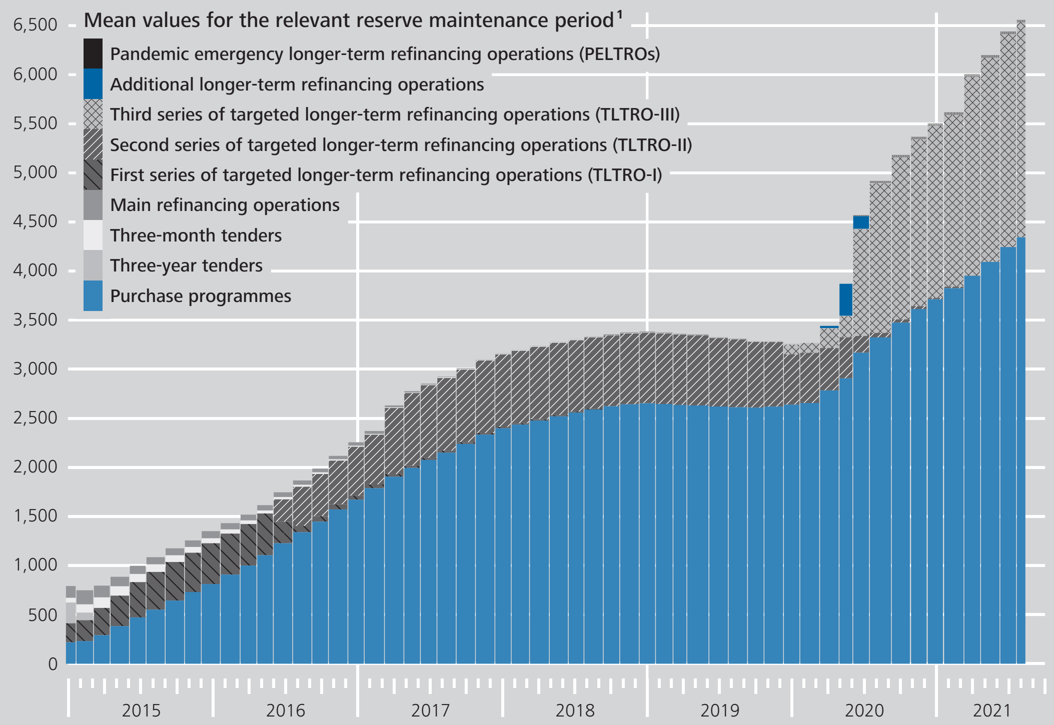
Outstanding liquidity broken down by open market operation in the euro area

€ 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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medium term. This target is symmetric, meaning negative and positive deviations of inflation from the target are equally undesirable. When the economy is operating close to the lower bound on nominal interest rates, it requires especially forceful or persistent monetary policy action to avoid negative deviations from the inflation target becoming entrenched. This may also imply a transitory period in which inflation is moderately above target.

ECB Governing Council amends forward guidance on key interest rates

Following its July monetary policy meeting, the Governing Council of the ECB confirmed its June assessment of financing conditions and the inflation outlook. Although it once again discussed potential upside risks, it assesses the baseline for the medium-term inflation outlook as remaining considerably below its target. Against this background, the Governing Council amended its forward guidance on the key ECB interest rates in line with its monetary policy strategy in order to support its new symmetric inflation target of 2%. It expects the key interest rates to remain at their present or lower levels until it sees inflation reaching 2% well ahead of the end of its projection horizon and durably for the rest of the projection horizon. It must also judge that realised progress in underlying inflation is sufficiently advanced to be consistent with inflation stabilising at 2% over the medium term. This may also imply a transitory period in which inflation is moderately above target, according to the Governing Council.

APP and PEPP securities holdings recorded on balance sheet see further expansion

APP holdings recorded on the balance sheet have risen by €49.8 billion since mid-May. On 13 August 2021, the Eurosystem as a whole held assets totalling €3,049.5 billion as part of the APP (see the box on pp. 29 ff. for a breakdown of the holdings by individual programme). The holdings continue to be influenced by the smoothing over time of reinvestments in line with the technical parameters agreed upon in December 2018 and by the use of amortised cost accounting.[2] On 13 August 2021, the securities holdings reported under the PEPP amounted to €1,296.9 billion, up by €243.8 billion.

Eighth TLTRO-III sees banks take up €109.8 billion

On 24 June 2021, the eighth operation of the third series of targeted longer-term refinancing operations (TLTRO-III) was settled, with 224 banks taking up a total of €109.8 billion. Overall, a combined volume of €2,189.1 billion is currently outstanding for all TLTRO-III operations. Uptake of the pandemic emergency longer-term refinancing operation (PELTRO) concluded on the same day, at €0.5 billion, was once again very low. A total of €24.8 billion are currently outstanding in the PELTROs.

Excess liquidity continues to rise

The trend increase in excess liquidity continued on account of the ongoing net asset purchases and the allotment of the eighth TLTRO-III operation. As this report went to press, the volume of excess liquidity stood at €4,335.1 billion, up by around €189 billion compared with mid-May (see the box on pp. 29 ff.).

Short-term money market rates continue to show little change

Short-term money market rates once again largely moved sideways. The unsecured euro overnight index average rate (EONIA), which is computed by applying a fixed spread to the euro short-term rate (€STR), was virtually unchanged at -0.48%. As this report went to press, the three-month EURIBOR was slightly lower at -0.54%; on the whole, there was very little movement here as well.

Money market forward rates declining

Money market forward rates have declined since the ECB Governing Council's monetary policy meeting in June. Part of the decline had already been apparent in mid-July, coinciding with the announcement of initial information on the outcome of the Governing Council's strategy review. Forward rates' response to the official publication of the outcome of the strategy review was then muted. Following the adjustment of forward guidance at the Governing Council's July meeting, short-term forward rates continued to fall. All in all, market participants are now no longer pricing in an increase in interest rates of 10 basis points before the end of 2024. According to surveys conducted before the Governing Council's monetary policy meetings, an overwhelming majority of respondents were not expecting any initial interest rate moves before mid-2024. Other factors alongside the outcome of the strategy review are likely to have contributed to the flattening of the forward curve, especially at the current end. These include, amongst other things, growing concerns about the spread of the Delta variant of the coronavirus and the potential for subsequent restrictions to economic activity.

Monetary developments in the euro area

Gradual normalisation of monetary dynamics

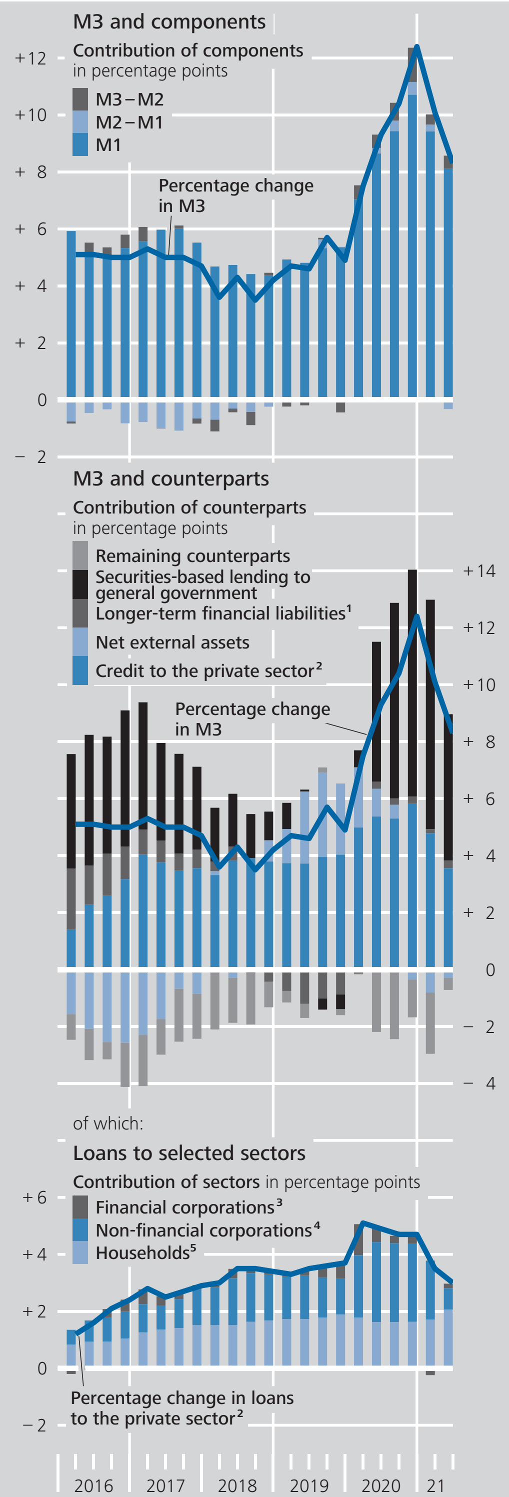
The broad monetary aggregate M3 showed considerable growth in the second quarter of 2021, too, driven as before by highly liquid overnight deposits. However, compared with the high pandemic-induced net inflows a year ago, the momentum of this expansion has tailed off considerably. This meant that the normalisation of monetary growth already seen in the previous quarter continued, as was also demonstrated by the decline in the annual growth rate of M3 of just under two percentage points over the course of the quarter to 8.3% at the end of June.

On the counterparts side, loans again made the largest contribution to monetary growth. The majority of this was securities-based lending to general government, driven by the Eurosystem's ongoing asset purchases. However, notable impetus also came from loans to the private sector, which were almost exclusively for house purchase. Non-financial corporations, by contrast, reduced their outstanding loans from banks. One reason for this was that the strong economic recovery improved their income situation. Another was that, as was already hap-

2 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.

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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pening in the previous quarters, funding was being shifted to the capital market. In addition, some firms that are now considerably more leveraged are likely to have exercised greater restraint with regard to further borrowing. At the same time, the banks participating in the Bank Lending Survey (BLS) reported that they had not tightened their corporate credit standards in the second quarter, counter to their own prior expectations.

Monetary expansion still driven by overnight deposits

Overnight deposits were once again the M3 component that made the most significant contribution to annual growth. As before, households accounted for the largest net inflows. However, inflows decreased significantly in volume and have now returned to pre-pandemic levels for the first time. The background behind this development is that households have had increasingly greater opportunities for consumption thanks to the gradual lifting of pandemic-related restrictions in the second quarter. The build-up of short-term savings deposits also decelerated perceptibly on the heels of this development.

Non-financial corporations likewise saw inflows to their overnight deposits continue to move back towards their pre-pandemic levels. For one thing, the more positive business climate for enterprises reduced their need to build up additional liquidity reserves. For another, improved earnings and optimistic business expectations in many areas boosted enterprises' propensity to invest. This aggregate picture, however, masks fairly heterogeneous developments in the individual euro area countries brought about by differences in the degree to which they have been affected by the pandemic.

Build-up of securitised lending mainly shaped by Eurosystem net purchases

On the counterparts side, monetary growth was once again driven primarily by domestic lending, which continued to fall relative to the strong previous quarters yet remained above its level prior to the outbreak of the coronavirus pandemic. This was due to securities-based lending to general government, which re-

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

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

Assets	Q1 2021	Q2 2021	Liabilities	Q1 2021	Q2 2021
Credit to private non-MFIs in the euro area	126.6	41.5	Holdings against central government[2]	− 49.4	− 42.8
of which:			Monetary aggregate M3	207.1	211.1
Loans[1]	114.7	36.5	of which components:		
Securities	11.9	5.0	Currency in circulation and overnight deposits (M1)	268.1	238.6
Credit to general government in the euro area	172.6	107.2	Other short-term deposits (M2-M1)	− 20.1	− 42.7
of which:			Marketable instruments (M3-M2)	− 40.8	15.2
Loans	− 1.7	11.8			
Securities	174.4	95.4	Longer-term financial liabilities	− 32.0	− 18.8
			of which:		
Net external assets	3.8	40.1	Capital and reserves	25.1	32.7
Other counterparts of M3	− 177.3	− 39.4	Other longer-term financial liabilities	− 57.1	− 51.5

* 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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mained elevated. While the Eurosystem markedly upped its net monthly purchases of government bonds under the APP and PEPP in the reporting quarter, commercial banks reduced their government bond holdings in net terms. At the same time, they expanded their lending to the domestic private sector, although to a significantly lesser extent compared with the preceding quarters. This decline affected both securities-based lending and, in particular, loans to the private sector, the annual growth rate of which dropped to 3% by the end of the quarter.

Net reduction in loans to non-financial corporations currently exaggerated by one-off effect …

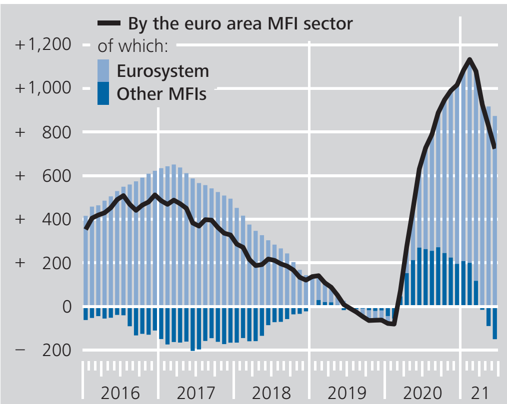
Banks' holdings of loans to non-financial corporations declined in the second quarter for the first time since 2015. One reason was a countermovement to the strong first quarter: as reported, some banks brought forward their short-term loans, in particular, ahead of 31 March in order to meet the credit growth targets applicable under TLTRO-III and thus qualify for very favourable funding conditions.[3] Moreover, the very high volume of lending in the second quarter of 2020 dampened short-term loans: one-year loans granted at that time, including a large number of bridging loans, matured in the reporting quarter. The high outflows in the short-term and medium-term maturity segments, however, contrasted with strong inflows in long-term maturities. This suggests that part of the loans previously granted as short-term loans have been either substituted by or converted into long-term loans.

… but signs of weaker demand for loans overall

Overall, non-financial corporations continued to take out loans in the first and second quarters of the year on balance, albeit to a lesser extent than in the preceding quarters. There are various reasons behind the weaker demand for loans. For instance, some enterprises continue to have large holdings of bank deposits;

Securities-based lending to general government in the euro area

€ billion, 12-month accumulated flows



Sources: ECB and Bundesbank calculations.
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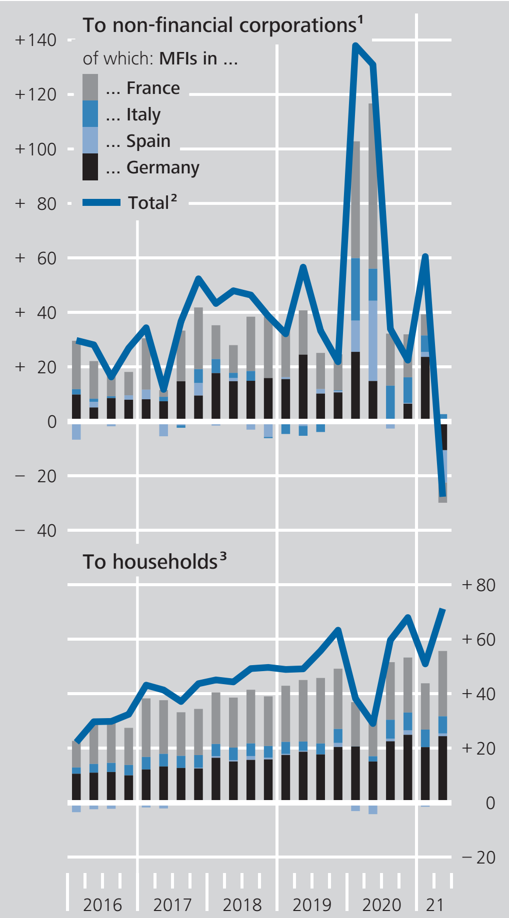
3 See Deutsche Bundesbank (2021a).

MFI loans to the non-financial private 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.
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these were accumulated last year for precautionary purposes and are now having a dampening effect on demand for further loans. This build-up of deposits was supported by the favourable conditions for bank loans, but also for alternative financing sources. For larger enterprises, this included obtaining funding directly on the capital market, in particular – mainly through the issuance of bonds last year and increasingly through the issuance of shares in the reporting quarter. By contrast, the muted credit demand amongst enterprises in the sectors hit especially hard by the pandemic is more likely to be attributable to the fact that these enterprises already have high levels of indebtedness in some cases and have become more reluctant to take out additional loans. Furthermore, particularly in Germany, extensive payments of government assistance to enterprises affected by the pandemic provided financial relief in the reporting quarter and also made loan repayments possible.

Increased financing needs for fixed investment

The fact that there was additional borrowing mainly in the form of long-term loans is indicative of a shift in the motives behind credit demand away from the primary safeguarding of liquidity and towards investment purposes. This is consistent with the view expressed by the bank managers responding to the BLS that demand for loans was bolstered by financing needs for fixed investment for the first time in six quarters. In addition, the surveyed banks observed an increase in other funding needs, generated by refinancing, restructuring and renegotiating, amongst other things.

BLS banks refrained from tightening standards further

At the same time, the surveyed banks stated that, on balance, they left their corporate credit standards virtually unchanged in the second quarter. In the previous survey, banks had reported that they planned to tighten credit standards for the current quarter. The fact that there was little change in standards is the result of contrasting factors: the general economic situation and the economic outlook encouraged more lenient standards, as did the competition with other banks and non-banks, as well as enterprises' ability to raise funds on the capital market at favourable terms. By contrast, sector-specific and firm-specific factors as well as a decline in borrowers' creditworthiness continued to have a restrictive effect.

Further significant increase in loans to households

Unlike in corporate banking business, banks in the euro area significantly increased their lending to households once again in the second quarter of 2021. In particular, loans for house purchase, which account for the bulk of activity in this credit segment, again grew at an even greater rate than during the strong second half of 2020. Their annual growth rate rose to 5.6% by the end of June, thus standing just over ½ percentage point higher than at the end of March. The most significant contributions to the quarterly inflow were again made by banks in Germany and France, but relatively strong stimulus also came from Italy in comparison with the pre-pandemic period. Banks in Spain recorded a significant quarterly net increase in this credit segment for the first time in just over ten years.

BLS banks report rise in demand for housing loans with essentially no change in credit standards

Accordingly, the banks surveyed by the BLS registered an increase in demand for loans to households for house purchase, reporting that consumer confidence strengthened demand for the first time since the onset of the coronavirus pandemic. Positive stimuli were also provided by the favourable outlook on the housing market and the low general level of interest rates. On the supply side, the banks participating in the survey left their standards for loans for house purchase virtually unchanged in the second quarter.

Recovery also seen in consumer credit and other lending to households

Consumer credit and other lending to households also increased markedly in the second quarter. BLS banks reported that this was primarily due to improved consumer confidence and households' greater propensity to acquire durable consumer goods. The low general level of interest rates also boosted demand. The surveyed banks left their credit standards for consumer credit and other loans to households unchanged, following considerable tightening in some quarters during the previous year. In addition, the rejection rate remained almost unchanged compared with the previous quarter, after having increased in the five preceding quarters. It is therefore currently likely to persist at a relatively high level.

Net external position provides marked support to monetary growth due to persistent current account surplus

Alongside lending to non-banks in the euro area, the net external position of the monetary financial institutions (MFI) sector[4] also supported monetary growth markedly in the second quarter of 2021. As usual, this was largely attributable to the persistent euro area current account surplus (according to non-seasonally adjusted balance of payments data, which are currently only available for April and May). A countervailing effect – one that led to capital exports – was generated by the negative balance of cross-border securities transactions: in view of the persistent difference in yield between bonds issued by other currency areas and those issued by the euro area, domestic non-banks continued to expand their holdings of foreign securities in net terms. By contrast, non-residents sold long-term bonds issued by domestic non-banks on balance, but, at the same time, purchased shares and investment fund shares on a larger scale, just as they had done in the previous quarter.

German banks' deposit and lending business with domestic customers

Deposit business positive once again, momentum waning

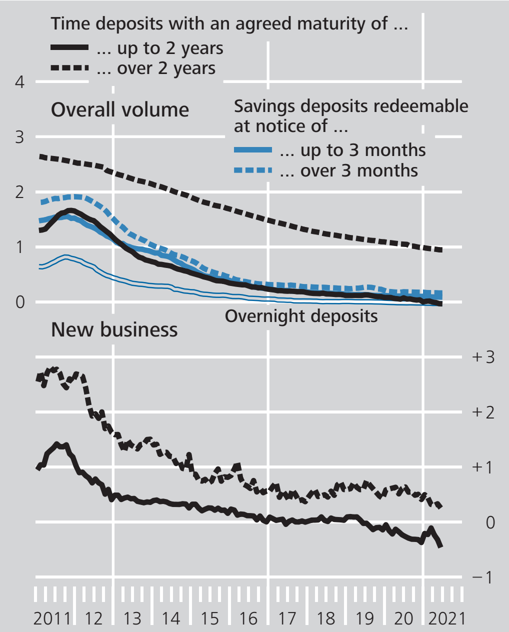
German banks' deposit business with domestic customers lost a significant amount of momentum in the second quarter of 2021, after recording extraordinarily sharp growth in some of the previous quarters against the backdrop of the coronavirus pandemic. The current developments first reflect the fact that households increased their consumer spending after the pandemic-related restrictions had been gradually eased. Second, given the economic recovery and improved economic outlook, enterprises had less need to safeguard their liquidity by building up short-term bank deposits. Furthermore, confidence in the economy led investors to search for yield by shifting funds from M3 deposit types into riskier and less liquid assets not included under M3. This development was also encouraged by the interest rates on M3 deposits, which were low and, in some cases, had fallen further into negative territory (see the chart on p. 38).

The current increase in bank deposits was driven entirely by households, which markedly

4 Alongside credit institutions, the MFI sector comprises electronic money institutions, money market funds and central banks.

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	2021 Q1	2021 Q2
Deposits of domestic non-MFIs[1]		
Overnight	89.4	22.1
With an agreed maturity of		
up to 2 years	– 21.1	– 9.9
over 2 years	– 8.1	– 7.3
Redeemable at notice of		
up to 3 months	3.1	1.5
over 3 months	– 1.1	– 0.8
Lending		
to domestic general government		
Loans	– 3.8	0.7
Securities	4.3	– 13.0
to domestic enterprises and households		
Loans[2]	38.7	14.6
of which: to households[3]	20.3	24.4
to non-financial corporations[4]	16.0	– 12.9
Securities	6.7	2.5

* 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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Noticeable increase in households' bank deposits again, considerable reduction seen in other sectors' deposits in some cases

topped up their overnight deposits once again, although the latest build-up was considerably weaker than it had been in the previous quarters in their case, too (for potential reasons behind this, see the box on pp. 39 ff.). Non-financial corporations, by contrast, slightly reduced their holdings of overnight deposits in the second quarter on balance, after having significantly increased them in some of the preceding quarters. As a result, the sustained accumulation of liquidity reserves in this sector that began at the onset of the coronavirus pandemic did not continue in the second quarter of 2021. Financial corporations, which traditionally have a distinct appetite for yield, markedly reduced their bank deposits again in favour of higher-yielding forms of investment in the second quarter.

Only slight expansion in credit business with non-banks

German banks' credit business with domestic customers, which had been remarkably strong in the preceding quarter, expanded only slightly in the second quarter and to a considerably lesser extent than before the outbreak of the coronavirus pandemic. On the one hand, banks noticeably reduced their holdings of government bonds in net terms. At the same time, the increase in lending to the private sector was relatively weak.

Decline in loans to non-financial corporations, also due to countermovement to previous quarter

The weak lending in the second quarter was attributable to a significant net reduction in loans to non-financial corporations. This reduction, amongst other things, represented a countermovement to the increase in loans to corporate customers in the preceding quarter, which – influenced by various factors – had been particularly high.[5] At the same time, demand for bank loans amongst enterprises was also dampened owing to the fact that the financing needs of enterprises particularly affected by the coronavirus pandemic were covered in part by the disbursement of government loans. The volume of these grants grew further in the second quarter and, in total, even exceeded the volume of emergency aid granted in the second quarter of 2020.

5 See Deutsche Bundesbank (2021a).

Developments in the real portfolio returns of households in Germany

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 2021.[1]

The total portfolio return of households is calculated based on their main sources of income. While interest payments are the only source of income a bank deposit can generate, for other types of financial asset, such as shares, debt securities, investment fund shares and claims on insurance corporations, income flows also depend on price effects. In addition, shares and investment funds that invest in equities commonly pay out dividends, too. Any attempt to calculate households' total portfolio return therefore needs to consider not just interest payments but these other components as well.

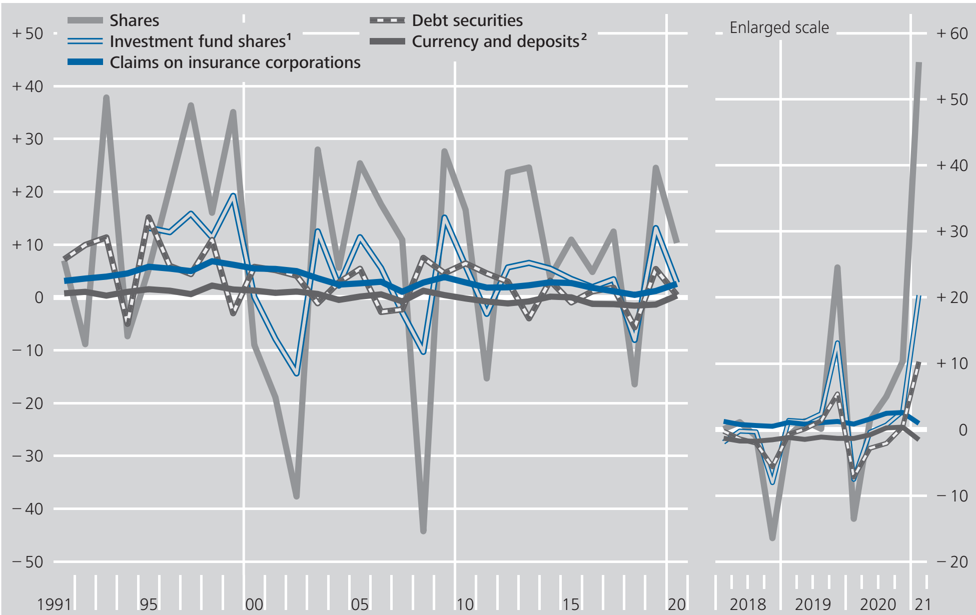
Consideration should also be given to the fact that the purchasing power of nominal returns fluctuates due to inflation, which is why all the returns are analysed in real terms.[2]

The chart below depicts the evolution of real returns on the main types of financial asset in the portfolio of households in Germany between 1991 and the first quarter of 2021. Currency and deposits remain 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

1 The following is an updated version of the box from the August 2020 edition of the Bundesbank's Monthly Report; see Deutsche Bundesbank (2020b).
2 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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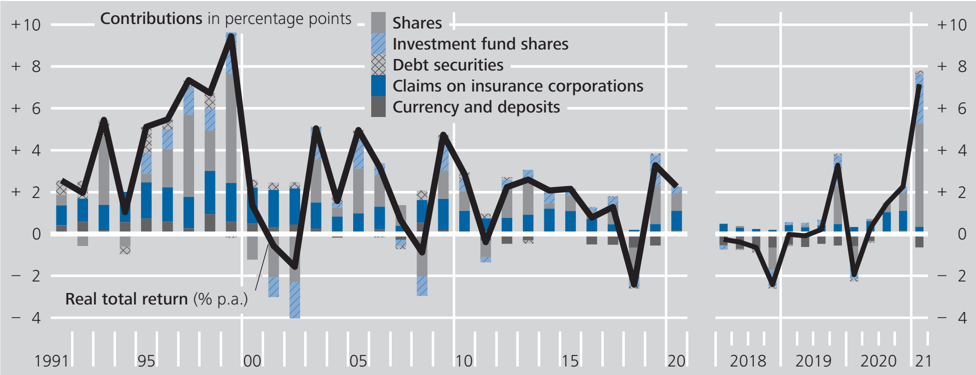
Contributions of individual types of financial asset* to the real total return of households in Germany

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).
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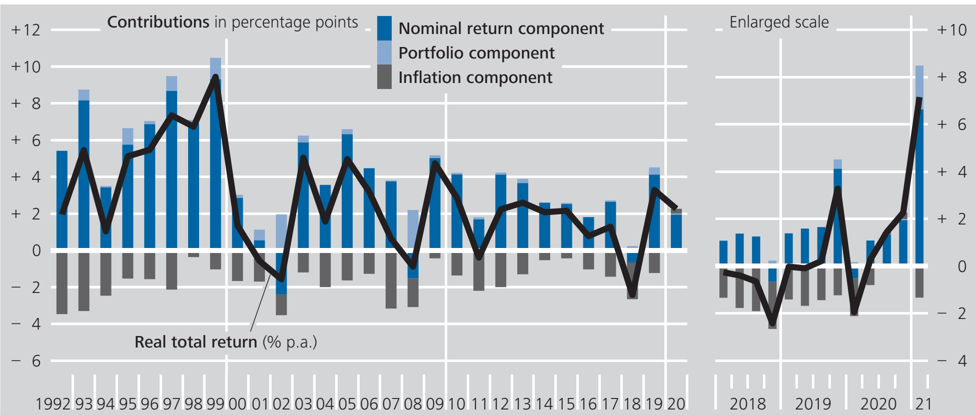
also been relatively immune to volatility. While there have also been instances in the past where the real return dropped below zero, since mid-2016 it has been clearly and almost exclusively negative. The situation is similar for debt securities, which, since mid-2015, have likewise yielded an almost consistently negative average real return, largely against the backdrop of the Eurosystem's asset purchase programme (APP) and pandemic emergency purchase programme (PEPP). The real return on insurance claims was given a boost by the temporary drop in the inflation rate brought about by the pandemic, but was heading back towards historical lows as this report went to press. Returns on shares and investment fund shares were, as usual, influenced strongly by capital markets. The onset of the COVID-19 pandemic and uncertainty surrounding its economic fallout initially sent prices tumbling in capital markets in the first quarter of 2020. Before long, however, the strong economic recovery in the summer of 2020 combined with monetary policy and fiscal support measures and a brighter economic outlook among market participants made themselves felt in capital markets, sending

Contributions to the real total return of households in Germany

Annual return at end of year/end of quarter



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returns on shares and investment fund shares perceptibly higher. It is particularly worth noting that, in annual terms, the first quarter of 2021 saw the real return on shares reach its highest value since records began in 1991.[3]

The real total portfolio return (see the upper chart on p. 40) is calculated by weighting the returns on the various asset types according to their share of the total household portfolio and adjusting the figures for consumer price inflation. Thus calculated, the real total return rose from -1.9% in the first quarter of 2020 to roughly 7.2% in the first quarter of 2021. This is the strongest recovery in the real total return within the space of a single year since records began.

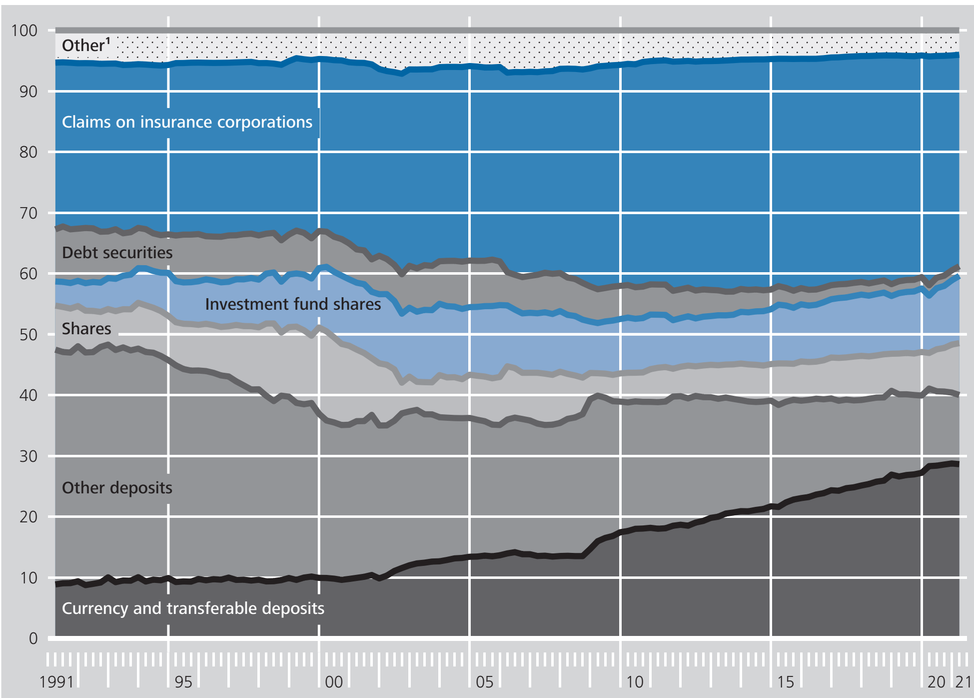
Viewed in multiyear terms, the contribution made by bank deposits, which has been predominantly negative since the end of 2010, has mostly dragged down the real total return overall. The contribution made by securities returns, meanwhile, has been fairly volatile, weighing on the total return in the final quarter of 2018 and at the beginning of 2020 in particular and turning clearly positive at the beginning of 2021. The only consistently positive contribution – 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 by nominal return, portfolio and inflation component (see the lower chart on p. 40). The nominal return component approximates the extent to which the (given) nominal return path of the different financial asset types – i.e. interest payments, price ef-

3 For more information about capital market developments in the first quarter of 2021, see Deutsche Bundesbank (2021b).

Structure of German households' financial assets

%, end-of-quarter data



1 Besides other accounts receivable, this also comprises other equity.
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fects and dividend payouts – 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 both nominal returns on individual components and the inflation rate 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 inflation component had a primarily negative effect in the period under review, as the inflation rate was above zero. Its contribution only turned positive for a time during 2020, when the inflation rate fell due to the pandemic. 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. 41).[4]

Overall, the aggregate rise in the nominal return component over the course of 2020 significantly boosted the real total return. At the beginning of 2021, the real total return was at a level last seen at the beginning of the millennium, in no small measure due to price gains in the capital market.

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

Sharp reduction in short-term and medium-term loans to enterprises, only slight increase in long-term loans

In terms of maturity, the latest decline in loans to non-financial corporations was attributable to substantial net repayments of short-term and medium-term loans. It appears that the improved income situation and the well-filled order books prompted some enterprises not to extend the loans they had taken out – for precautionary reasons in some cases – but rather to repay them. By contrast, long-term loans to non-financial corporations saw another increase in the second quarter of 2021, suggesting ongoing financing needs for investment purposes. However, quarterly inflows remained below the level of the preceding quarter for the second consecutive quarter. It should, however, be taken into consideration that enterprises made increasing use of alternative funding options in the second quarter, such as internal funding and/or capital market funding.

The results of the BLS largely support this view. Contrary to their expectations in the previous quarter, BLS banks reported no further increase in corporate customers’ financing needs on balance in the reporting quarter. Enterprises’ use of internal financing and borrowing from other banks had a dampening effect on demand. By contrast, financing needs for fixed investment drove up demand for loans. BLS banks also cited refinancing, restructuring and renegotiating as factors that boosted demand when viewed in isolation. However, they had less of an impact than in the preceding quarters.

BLS indicates that internal financing and borrowing from other banks dampened demand

Supply-side policy eased somewhat overall

At the same time, the surveyed banks eased their corporate credit standards marginally in net terms in the second quarter of 2021. Credit standards were therefore not tightened on balance for the first time since COVID-19 emerged in Germany in the first quarter of 2020. The second quarter of 2021 saw a net easing of credit terms and conditions as a whole for the time since 2019. Institutions cited several reasons that all marginally influenced this easing. These included increased risk tolerance, greater optimism about the situations of individual sectors and enterprises as well as borrowers' creditworthiness, and a more positive assessment of the general economic situation and outlook. In the previous quarter, these factors had still had a restrictive effect on standards.

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

Unlike the corporate customer segment, loans to households registered substantial inflows again in the second quarter. This was primarily due to households' high demand for loans for house purchase, which saw a marked increase again in the second quarter. The sharp rise in prices for construction work and residential property was probably also another determinant alongside households' sound income and asset situation and favourable financing conditions. On balance, the growth rate of loans taken out for house purchase rose further to 7.1% on the year, reaching its highest level since 2000. According to MFI interest rate statistics, the interest rate on long-term loans for house purchase was 1.3% in the second quarter of 2021 and thus only slightly above the historical low of 1.1% recorded at the end of December 2020 (see the chart on p. 44).

Demand for housing loans supported by consumer confidence and low interest rate environment

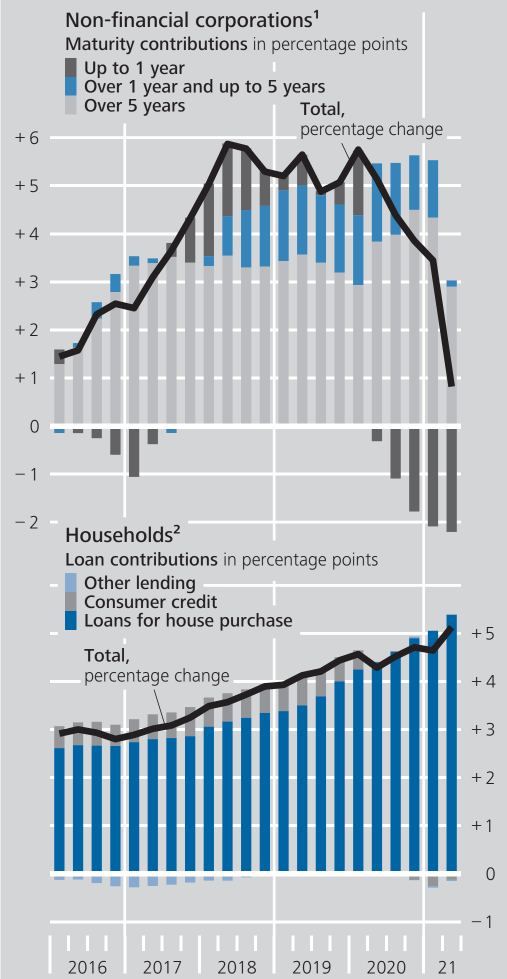
The latest BLS suggests that other factors were at play as well. The surveyed banks cited improved consumer confidence as a key reason for the increase in demand currently observed in this credit segment. This factor therefore contributed to an increase in demand for the first time since the start of the pandemic. Banks cited the low general level of interest rates as a second key factor.

Lending policies for loans for house purchase eased for first time since outbreak of coronavirus pandemic

Credit standards for loans to households for house purchase were eased for the first time since the outbreak of the coronavirus pandemic – and to a somewhat greater extent than banks had planned in the previous quarter. Despite the easing of standards, the rejection rate was slightly up on the quarter. Following the increases observed in the second, third and fourth quarters of 2020, this rate is currently likely to remain at an elevated level compared with the rate immediately before the

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

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



* Adjusted for loan sales and securitisation. **1** Non-financial corporations and quasi-corporations. **2** Including non-profit institutions serving households.
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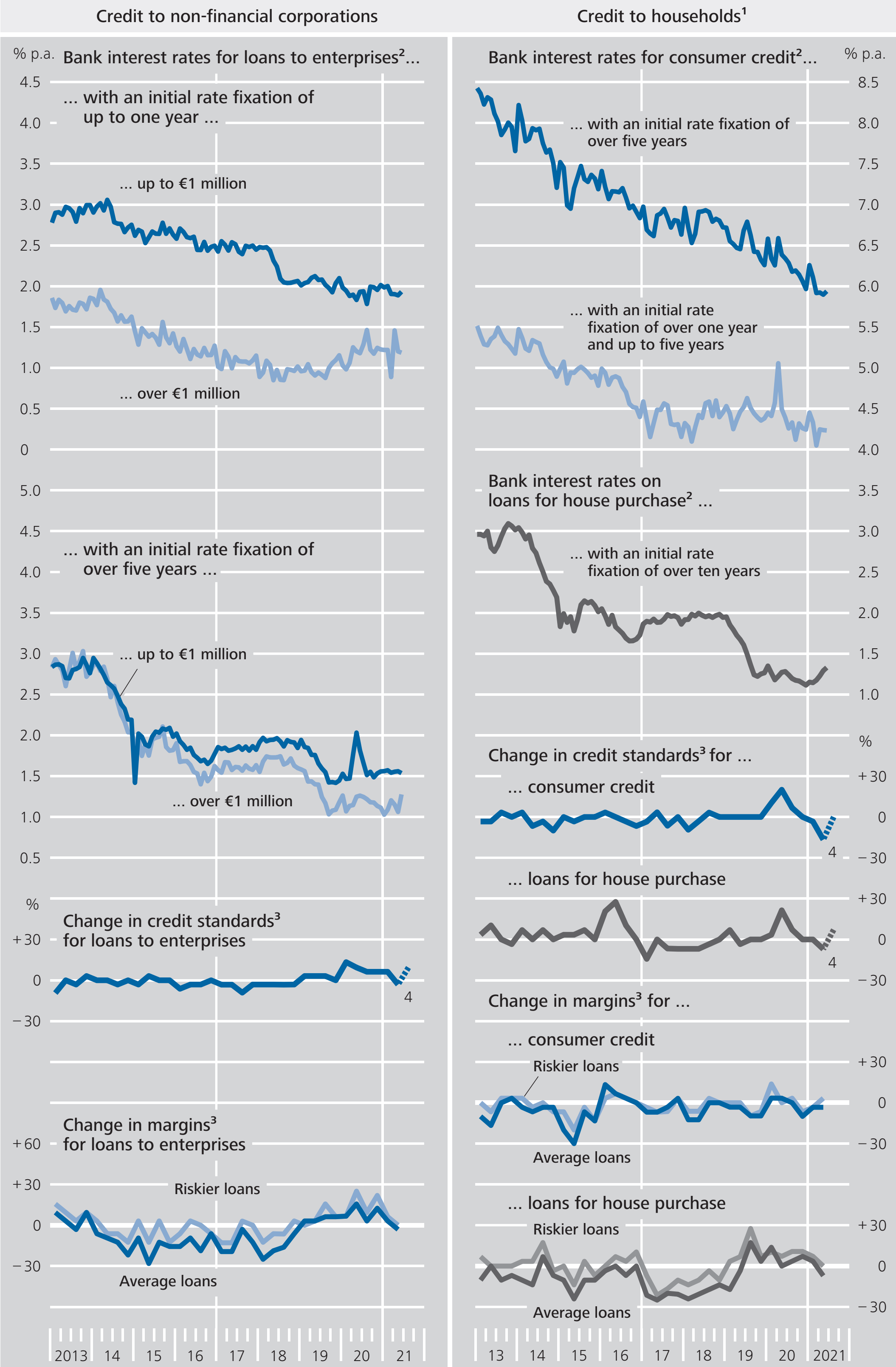
outbreak of the coronavirus pandemic. Furthermore, credit terms and conditions were eased again for the first time since the second quarter of 2019. As a result, banks narrowed the margins on average loans for the first time in two years, while the margins on riskier loans were not widened for the first time. The BLS banks were also accommodative to borrowers with regard to their loan-to-value ratios.

NPL ratio had no impact on German banks' lending policy in first half of 2021

In response to the ad hoc questions in the July survey, German BLS banks reported that their funding conditions had remained largely unchanged compared with the previous quarter. According to the banks, the share of non-

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 2021.

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performing loans (NPLs) in the gross book value of loans – i.e. the NPL ratio – had no impact on changes to their lending policies for loans to enterprises or households in the first half of 2021. For the second half of 2021, banks are expecting to see a marginally restrictive effect on credit standards and terms and conditions for loans to enterprises.

Significant decline in corporate demand for government-guaranteed coronavirus assistance loans in first half of 2021

Banks reported a significant decline in corporate demand for government-guaranteed coronavirus assistance loans in the first half of 2021. One reason for this was that large enterprises, in particular, had shown less demand for funding to cover acute liquidity needs.

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