Monetary policy and banking business

Monetary policy and money market developments

ECB Governing Council decides to end APP net asset purchases as of 1 July

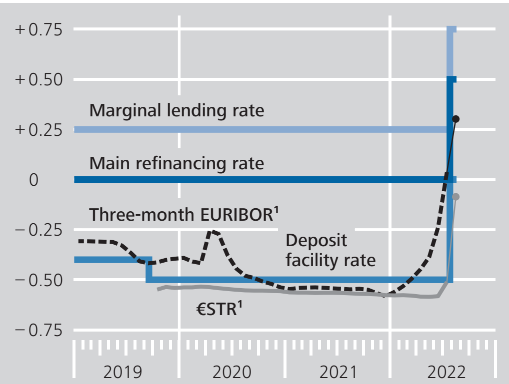
In June, the ECB Governing Council decided, on the basis of its updated assessment of the inflation outlook, to take further steps in normalising its monetary policy. It decided to end net asset purchases under the asset purchase programme (APP) as of 1 July 2022. In addition, the Governing Council concluded that the conditions formulated in the previous year for raising the key ECB interest rates had now been satisfied. Accordingly, and in line with the ECB's policy sequencing, the Governing Council expressed its intention to increase the key ECB interest rates by 25 basis points at its July monetary policy meeting. The Governing Council also communicated the expectation that it would raise the key ECB interest rates again in September and possibly by a larger increment. It furthermore anticipated a gradual but sustained path of further increases in interest rates beyond September.

Flexibility in PEPP reinvestments applied in June

On 15 June, the Governing Council held an ad hoc meeting to exchange views on the current market situation. It assessed that the pandemic had left lasting vulnerabilities in the euro area economy which, in the Governing Council's view, were contributing to the uneven transmission of the normalisation of monetary policy across jurisdictions. Based on this assessment, the Governing Council decided that it would apply flexibility in reinvesting redemptions coming due in the pandemic emergency purchase programme (PEPP) portfolio. This specifically means that PEPP redemptions will no longer necessarily be reinvested in the jurisdictions in which they fall due. Instead, those redemptions can, as appropriate, be reinvested in jurisdictions in which the Governing Council considers orderly transmission to be at risk, with a view to preserving the functioning of the monetary policy transmission mechanism. The Governing Council considers this a precondition for it to be able to deliver on its price stability mandate. It decided to apply this flexibility as of 1 July. The Governing Council also decided on 15 June to mandate the relevant Eurosystem Committees together with the ECB services to accelerate the completion of the design of a new anti-fragmentation instrument.

Money market interest rates in the euro area

% p.a.



Sources: ECB and Bloomberg. **1** Monthly averages. • Average 1 to 18 August 2022.
Deutsche Bundesbank

ECB Governing Council raises key ECB interest rates by 50 basis points in July

The Governing Council took further key steps in July to make sure inflation returns to its 2% target over the medium term. It judged that, in light of the further increase in inflation risks, it was appropriate to take a larger first step on its policy rate normalisation path than signalled at the June meeting. The Governing Council therefore decided to raise the three key ECB interest rates by 50 basis points. Accordingly, the interest rate on the deposit facility now stands at 0%, while the interest rate on the main refinancing operations is 0.5% and the interest rate on the marginal lending facility is 0.75%. The Governing Council furthermore reaffirmed its view that further normalisation of interest rates would be appropriate. In the Governing Council's view, the frontloading of the exit from negative interest rates allows it to make a transition to a meeting-by-meeting approach to interest rate decisions. The future

Money market management and liquidity needs

In the period under review from April to July 2022,[1] excess liquidity in the Eurosystem declined by a total of €24.2 billion to an average of €4,461.1 billion. It initially increased by €84.3 billion to €4,569.7 billion in the third reserve maintenance period of 2022 (April-June). The subsequent decline of €108.5 billion in the fourth reserve maintenance period of 2022 (June-July) was due, first, to early repayments of longer-term refinancing operations as at 29 June 2022. Second, liquidity-absorbing autonomous factors increased in the fourth reserve maintenance period of the year compared with the second reserve maintenance period.

In the period under review, additional central bank liquidity was provided through a total of €69.6 billion worth of net asset purchases conducted as part of the asset purchase programme (APP). Net purchases under the APP were discontinued as of 1 July 2022. As at 12 August 2022, the balance sheet holdings of the asset purchase programmes amounted to €4,953.4 billion (see the table below). Meanwhile, the average outstanding tender volume in the euro area fell by €49.8 billion to €2,150.3 billion in the period under review, resulting in net liquidity absorption. On 29 June 2022, a total of €74.1 billion out of all the targeted longer-term refinancing operations of the third series (TLTRO-III) was voluntarily repaid ahead of schedule. Moreover, during the period under review, liquidity amounting to €0.5 billion was repaid at maturity under the pandemic emergency longer-term refinancing operations (PELTROs). Although the volume in the regular main refinancing operations and three-month tenders remained at a very low level, demand increased

1 The averages of the fourth reserve maintenance period of 2022 (June-July 2022) are compared here with the averages of the second reserve maintenance period of 2022 (March-April 2022).

Factors determining banks' liquidity*

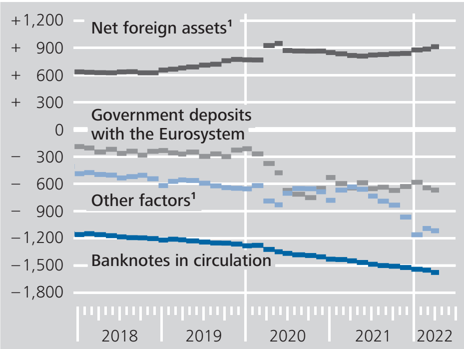
€ billion; changes in the daily averages of the reserve maintenance periods vis-à-vis the previous period

Item	2022 20 Apr. to 14 June	2022 15 June to 26 July
I. Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors		
1. Banknotes in circulation (increase: –)	– 15.6	– 12.5
2. Government deposits with the Eurosystem (increase: –)	+ 43.7	– 43.5
3. Net foreign assets[1]	+ 21.0	+ 9.5
4. Other factors[1]	– 12.4	– 28.9
Total	+ 36.7	– 75.4
II. Monetary policy operations of the Eurosystem		
1. Open market operations		
a) Main refinancing operations	+ 0.1	+ 0.5
b) Longer-term refinancing operations	– 1.0	– 49.4
c) Other operations	+ 49.9	+ 19.7
2. Standing facilities		
a) Marginal lending facility	+ 0.0	+ 0.0
b) Deposit facility (increase: –)	+ 33.6	+ 2.6
Total	+ 82.6	– 26.6
III. Change in credit institutions' current accounts (I. + II.)	+ 118.8	– 102.8
IV. Change in the minimum reserve requirement (increase: –)	– 1.0	– 3.1

* 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

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 12 Aug. 2022
Active programmes[1]		
PSPP	+ 56.4	2,590.2
CBPP3	+ 5.5	301.1
CSPP	+ 13.6	344.4
ABSPP	− 1.6	24.6
PEPP	− 3.6	1,689.6
Completed programmes		
SMP	+ 0.0	3.4
CBPP1	+ 0.0	0.0
CBPP2	− 0.7	0.1

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

slightly in both, particularly in the context of early TLTRO-III repayments. In Germany, the outstanding volume of all refinancing operations fell by €11.4 billion to an average of €409.4 billion. As a result, German banks' share of the outstanding volume of refinancing operations in the Eurosystem came to around 19.0%.

In the fourth reserve maintenance period of 2022, liquidity needs in the euro area stemming from autonomous factors rose by €40.0 billion compared with the second reserve maintenance period of 2022, reaching a new average record high of €2,487.2 billion. This was mainly due to an increase in the value of banknotes in circulation by €28.1 billion to €1,604.0 billion. Net banknote issuance, which absorbs liquidity, went up markedly in Germany, by €17.1 billion to €919.5 billion. In the last week of the fourth reserve maintenance period of 2022, net banknote issuance declined owing to banknote inpayments from banks' cash holdings, inter alia, that were higher than usual for the time of year. By contrast, the decline in the balances of non-euro area central banks, which is included under "other factors", had a liquidity-providing effect. Government deposits remained virtually unchanged and therefore had no notable impact on central bank liquidity. Over the reporting period, the minimum reserve requirement in the Eurosystem climbed significantly, by €4.1 billion to €160.9 billion, thus further increasing the need for central bank liquidity. In Germany, the reserve requirement only went up by €0.7 billion to €43.9 billion.

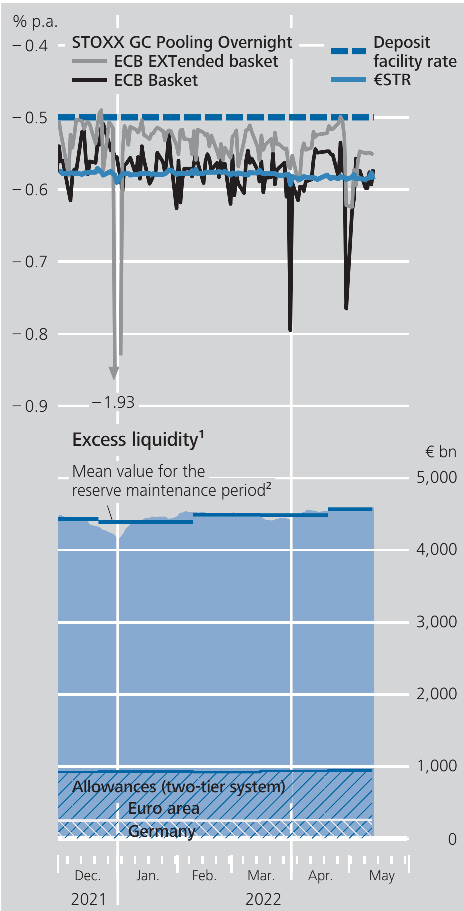
At 98% and 99%, respectively, banks' utilisation of exemption allowances under the two-tier system for remuneration of excess reserve holdings remained virtually unchanged for both the euro area and Germany in the period under review. As excess liquidity fell by €24.2 billion, the share of excess liquidity exempted from the negative interest rate increased (see the chart on p. 31). As a result, on average in the fourth reserve maintenance period of 2022, 21.3% of the excess liquidity in the Eurosystem was exempt from negative remuneration, which was 0.5 percentage point more than in the previous reserve maintenance period (in Germany: 20.8% compared with 20.2% in the second reserve maintenance period of 2022).

Overnight rates in the euro money market were moved towards the deposit facility rate of -0.50% in the third and fourth reserve maintenance periods of 2022 (see the chart on p. 31). The downward trend in overnight rates did not continue, with excess liquidity remaining high, but stagnating. In both the third and fourth reserve maintenance periods of 2022, the unsecured euro short-term rate (€STR) averaged -0.58%. At €48.5 billion in the third reserve maintenance period of 2022, turnover was lower on average than in previous periods (-€3.2 billion compared with the second reserve maintenance period of 2022). This was also attributable to public holidays. The average rose again to €53.2 billion in the subsequent reserve maintenance period. On the GC Pooling trading platform, overnight transactions in the ECB basket took place at an average of -0.58% in the third and fourth reserve maintenance periods of 2022, compared with the previous figure of -0.59% in the second reserve maintenance period of 2022. By contrast, in the ECB EXTended basket, which has a broader selection of securities with lower rating requirements for concluding repo transactions, overnight trading took place at a rate of -0.53% in the reporting period – unchanged from the second reserve maintenance period of 2022. End dates continued to have an impact on interest rates and transaction volumes in overnight trading. At the end of the first half of the year, the €STR was down by more than 1 basis point at -0.59%, much like at previous quarter-end dates. The effects of end dates were also observable in secured overnight trading on the GC Pooling platform, though greater differences were in evidence here between the two aforementioned collateral baskets as well as between the individual months. One reason for this could be the low trading volumes, which declined again at the end dates. However, higher transaction volumes were already in evidence in secured overnight trading in the fourth reserve maintenance period of 2022 compared with the previous period. This development has continued to date.

With the start of the fifth reserve maintenance period of 2022 (July-September) on 27 July 2022, overnight rates were moved towards the new deposit facility rate of 0%, increasing significantly. €STR climbed by 49.6 basis points on the day to -0.09% compared with the previous day. In secured overnight trading, the rates for the ECB basket and the ECB EXTended basket rose to -0.16% and -0.09%, respectively. This was equivalent to a rise of just 41 basis points and 46 basis points, respectively, on the previous day. In both collateral baskets, the rise in key interest rates was only fully passed through after the end of the month.

Deposit facility rate, money market rates and excess liquidity

Daily data

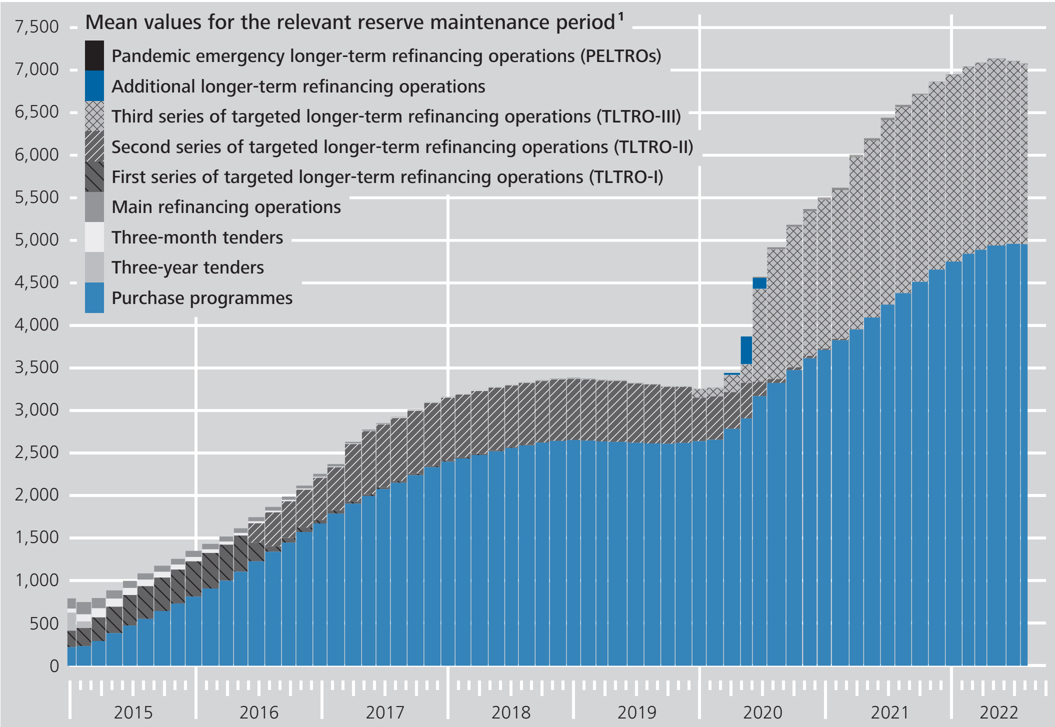


Sources: ECB, Eurex Repo and Bundesbank calculations. **1** Central bank balance minus the minimum reserve requirement plus the deposit facility. **2** The last period displayed is still ongoing.

Deutsche Bundesbank

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

policy rate path will continue to be data-dependent. In the context of its policy normalisation, the Governing Council will furthermore evaluate options for remunerating excess liquidity holdings.

New Transmission Protection Instrument

Moreover, the Governing Council approved a new instrument, the Transmission Protection Instrument (TPI). As the Governing Council continues normalising monetary policy, the TPI will ensure that the monetary policy stance is transmitted smoothly across all euro area countries. This will allow the Governing Council to more effectively deliver on its price stability mandate. This instrument can be activated to counter unwarranted, disorderly market dynamics that, in the Governing Council's view, pose a serious threat to the transmission of monetary policy across the euro area. Under the TPI, the Eurosystem will be able to make secondary market purchases of securities issued in jurisdictions experiencing a deterioration in financing conditions not warranted by country-specific fundamentals. TPI purchases would be focused on public sector securities with a remaining maturity of between one and ten years. Purchases of private sector securities could be considered, if appropriate. The scale of TPI purchases would depend on the severity of the risks facing monetary policy transmission. Purchases are not restricted ex ante.

TPI activation based on a comprehensive assessment

Any decision by the Governing Council to activate the TPI will be based on a comprehensive assessment of market and transmission indicators and an evaluation of the eligibility criteria. The Governing Council will consider a list of criteria to assess whether the jurisdictions in which the Eurosystem may conduct purchases under the TPI pursue sound and sustainable fiscal and macroeconomic policies.[1] The decision will also be based on a judgement that the activation of purchases under the TPI is propor-

1 For more details on these criteria, see European Central Bank (2022).

tionate to the achievement of the ECB's primary objective of price stability. Purchases would be terminated either upon a durable improvement in transmission, or based on an assessment that persistent tensions are due to country fundamentals.

Inflation pressures increasingly broad and intense

The decisions in June and July took place against the backdrop of inflation pressures that are becoming increasingly broad and intense, as reflected by considerable rises in the prices of many goods and services. Furthermore, Eurosystem staff once again revised their baseline inflation projections up significantly in their June projections compared with March, raising them to 6.8% in 2022, 3.5% in 2023 and 2.1% in 2024. The projections thus indicated yet again that inflation will remain undesirably elevated for some time and still be above target even at the end of the projection horizon. Moreover, this outlook remains subject to upside risks. These have increased, especially over the short term.

€STR increase matches key ECB interest rate hike

Closing the period under review at -0.09%, the euro short-term rate (€STR) was around 50 basis points higher than it was before the key ECB interest rate hike, which means it increased more or less in step with the policy rate. The three-month EURIBOR continued to rise as well, closing the period at 0.26%, which was around 68 basis points up on its level in mid-May. The three-month EURIBOR is thus already reflecting expectations of further key interest rate hikes in the coming months.

Money market forward rates signalling expectations of further interest rate steps

Money market forward rates are likewise signalling expectations of further key interest rate hikes for 2022 following the first interest rate step in July. Market participants are almost fully pricing in an interest rate step of a further 50 basis points at the current end for September 2022. Moreover, the shape of the money market forward curve is currently suggesting that market participants are expecting an additional 50 basis points of interest rate hikes for 2022 beyond September. At the current end, however, money market forward rates as of 2023 are markedly flatter than they had been in June. This would indicate that market participants are pricing in the Eurosystem raising its key interest rates in the coming year less strongly than had been expected as recently as June. Overall, the forward curve has been highly volatile in recent months, reflecting the exceptionally high uncertainty surrounding the inflation and growth outlook. The rounds of the ECB Survey of Monetary Analysts conducted ahead of the June and July meetings confirmed expectations of further interest rate hikes. Ahead of the July meeting, survey respondents were likewise expecting a median of a 50 basis point interest rate hike in September and further interest rate steps over the remainder of the year. However, as the survey had already been completed before the July decisions, survey participants were not yet able to factor July's higher-than-expected interest rate step into their considerations.

APP net asset purchases ended as of 1 July

APP holdings recorded on the balance sheet have risen by €25 billion since mid-May. On 12 August, the Eurosystem was holding assets totalling €3,260.3 billion under the APP (see the box on pp. 29 ff. for a breakdown of the holdings by individual programme). Net asset purchases under the APP were ended as of 1 July, in line with the Governing Council's decision in June. Securities holdings reported under the PEPP amounted to €1,689.6 billion on 12 August, down by €11.5 billion. Following the end of net asset purchases, the holdings reported under both purchase programmes continue to be influenced by the smoothing over time of reinvestments and by the use of amortised cost accounting.[2]

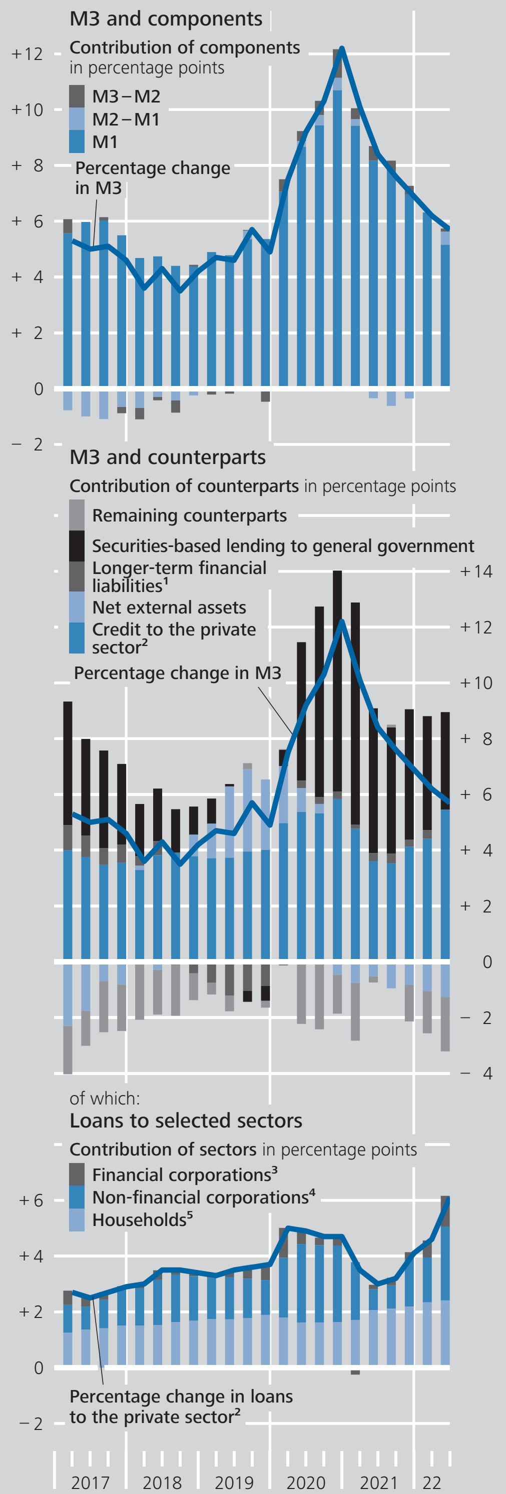
Excess liquidity down slightly

Excess liquidity has declined slightly overall since mid-May. As this report went to press, it came to a volume of €4,479.1 billion, down by around €90 billion (see the box on pp. 29 ff.). The voluntary repayment of the third series of

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.

Deutsche Bundesbank

targeted longer-term refinancing operations (TLTRO-III) in June is likely to have been a key factor in this decline. In total, banks repaid €74.0 billion on 29 June, which means that €2,121.7 billion is still outstanding under the third series of TLTROs.

Monetary developments in the euro area

Monetary growth moderating further

In the second quarter of 2022, the expansion of the broad monetary aggregate M3 was again smaller than it had been in the previous quarters. The annual rate fell further to 5.7%, leaving it only slightly above its level prior to the coronavirus pandemic. The continued moderation of monetary growth was the result of the scheduled reduction of net asset purchases by the Eurosystem. Loans to non-financial corporations and households in the euro area, meanwhile, posted yet another steep rise in the second quarter. For enterprises, it was notably the massive trade restrictions and the increased purchase prices that drove demand for loans. The banks surveyed in the Bank Lending Survey (BLS) reported tightening credit standards for loans to enterprises and to households for house purchase to roughly the same extent as they had done two years ago in the first year of the coronavirus pandemic. They put this down to what they saw as an increase in credit risk and a decrease in their risk tolerance.

Accumulation of overnight deposits tailed off further

Overnight deposits were still the M3 component that contributed most to the build-up in the monetary aggregate in the second quarter. However, their growth declined noticeably again on what had already been a weaker previous quarter. This was mainly because the increased prices meant that households and enterprises alike were only able to form new savings to a small extent. Households, which are generally less sensitive to interest rates than enterprises, continued to mainly accumulate overnight deposits. Non-financial corporations, meanwhile, stepped up their accumulation of time deposits, the interest rate on which had

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

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

Assets	Q1 2022	Q2 2022	Liabilities	Q1 2022	Q2 2022
Credit to private non-MFIs in the euro area	193.6	202.6	Holdings against central government[2]	– 53.2	15.3
Loans	186.5	218.4	Monetary aggregate M3	178.8	151.3
Loans, adjusted[1]	168.6	242.7	Components:		
Securities	7.1	– 15.8	Currency in circulation and overnight deposits (M1)	194.7	84.3
Credit to general government in the euro area	94.0	78.7	Other short-term deposits (M2-M1)	22.0	39.1
Loans	4.8	3.3	Marketable instruments (M3-M2)	– 37.9	27.9
Securities	89.2	74.7			
			Longer-term financial liabilities	– 37.3	28.6
Net external assets	– 23.5	– 51.5	Capital and reserves	10.6	53.0
Other counterparts of M3	– 175.7	– 33.9	Other longer-term financial liabilities	– 47.9	– 24.4

* 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

risen markedly in the second quarter, while the increase in their overnight deposits came to a halt. Overall, however, growth in short-term time and savings deposits was significantly smaller than the slowdown in overnight deposits. Demand for currency, which had been far above average in the previous quarter, also shrank again significantly. The decline in demand for currency indicated that the preference for liquidity has tailed off, to a degree, after having picked up sharply initially when hostilities broke out against Ukraine.

Strong build-up of loans to non-financial corporations, mainly due to increased inventory and working capital costs, …

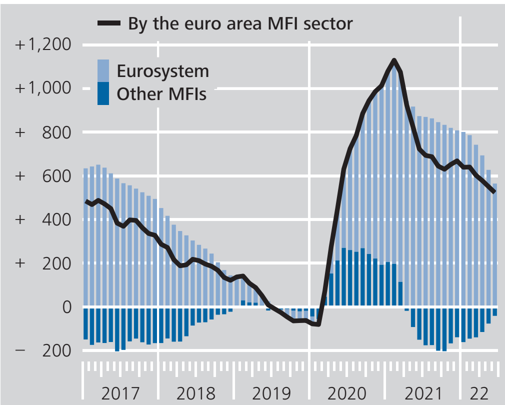
On the counterparts side, monetary growth in the second quarter was driven primarily by loans to the euro area private sector. The bulk of this was accounted for by loans to non-financial corporations (see the chart on p. 36). Inflows were spread across all maturity bands but particularly high, relative to the average take-up in recent years, for short-term loans. The AnaCredit credit microdata statistics for April and May reveal that this was mainly due to large enterprises stepping up their short-term loans. This observation is backed up by findings from the BLS: the surveyed banks observed an increase in credit demand in the second quarter, attributing the rise primarily to enterprises' increased financing needs for inventories and working capital. These needs were stronger among large enterprises, which appear to be particularly exposed to current disruptions in supply chains and mounting purchase prices on account of their international ties.

… while financing needs for fixed investment have receded

Medium and long-term loans to non-financial corporations were another segment in which banks registered robust inflows in the second quarter. BLS respondents reported that borrowers also used the borrowed funds for debt refinancing, restructuring and renegotiation as well as for the redemption of debt securities. This may have something to do with the fact that bank lending rates have so far increased

Securities-based lending to general government in the euro area

€ billion, 12-month accumulated flows

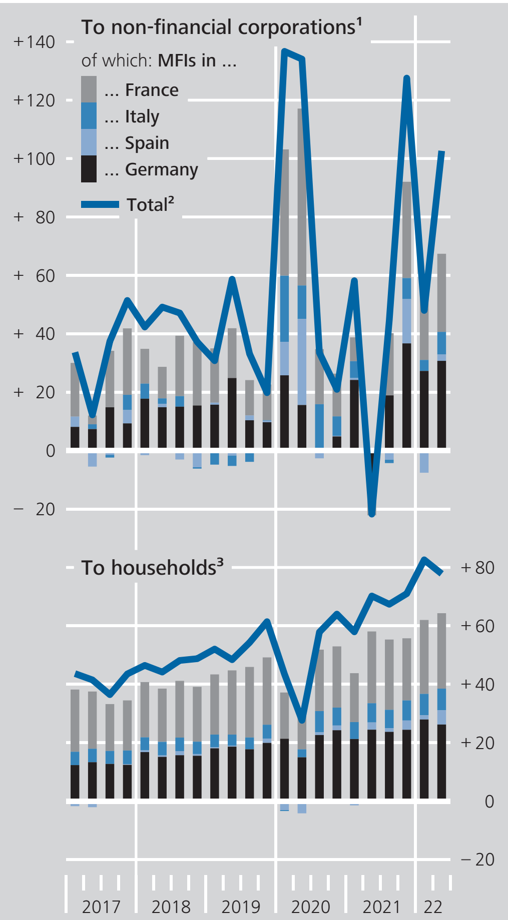


Sources: ECB and Bundesbank calculations.

Deutsche Bundesbank

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.
Deutsche Bundesbank

less rapidly than corporate bond yields, which created favourable conditions for replacing securities-based loans with traditional loans. By contrast, BLS reporting banks judged that enterprises' financing requirements for fixed investment fell for the first time in five quarters. This could be a reflection of uncertainty stemming from supply chain problems and the repercussions of the Ukraine war.

Loan dynamics mixed at the country level

The sharp increase in lending during the reporting quarter combined with the unusually weak second quarter of 2021 meant that there was a robust uptick in the annual growth rate of loans to non-financial corporations, which stood at 6.8% at the end of June.[3] Aggregate growth figures obscure mixed loan dynamics at the country level, however. While banks in Germany and France continued to lend briskly, the impulses from Spain and Italy were significantly smaller, above all for medium and long-term loans. One likely reason for this is that Spanish and Italian enterprises currently still have funds left over from the government-guaranteed loans they were able to take out at favourable conditions and with long maturities at the onset of the coronavirus pandemic.[4] Country-specific differences are also evident in the increases in lending rates observed in the year to date. However, these differences can be readily explained so far by the regularities observed in the past.

BLS reporting banks noticeably tightened credit standards in corporate lending

The strong growth in lending occurred against the backdrop of more restrictive lending policies among banks. At the aggregate level, the banks surveyed by the BLS significantly tightened their corporate credit standards in the second quarter. The main reasons cited were the perceived deteriorations in both the economic situation and outlook as well as in sector-specific and firm-specific factors. Lower risk tolerance also contributed to tighter standards. In addition, banks reported that the war against Ukraine had a restrictive effect.

Further substantial rise in loans to households for house purchase, …

There was brisk demand for loans among households, too. This was particularly true of loans for house purchase as the most important sub-component. In the balance sheet statistics, the banks reported renewed large inflows to this credit segment in net terms. The data refer to loans for house purchase that are recorded on the balance sheet, i.e. that have already been disbursed. Their annual growth

3 Lending to non-financial corporations was on the decline in the second quarter of 2021. This related to the interest rate conditions for the TLTRO-III: in order to meet the lending performance thresholds at the end of March 2021 and thus benefit from very favourable refinancing conditions for 2020-21, some banks frontloaded their lending in the first quarter.
4 See Banco de España (2022) and Banca d'Italia (2022a, 2022b).

rate remained virtually unchanged at 5.3% at the end of June. However, the BLS responses indicate that this momentum is likely to wane in the coming months. Based on incoming loan requests, the BLS reporting banks observed a decline in demand for housing loans in the second quarter. They expect a further decrease in the third quarter. The surveyed banks attributed the decline observed in the reporting quarter to lower consumer confidence, in particular. In addition, according to BLS data, the rise in the general level of interest rates pushed down demand for the first time since the beginning of 2015, when data on this factor was first collected.

… credit standards tightened considerably according to BLS

There were also adjustments to lending policy – the banks responding to the BLS stated that credit standards for housing loans were tightened to an extent last seen in 2020, the first year of the coronavirus pandemic. From the banks' perspective, this was triggered by increased credit risk. This was caused in part by a downturn in the general economic situation and the gloomier outlook on the residential real estate market, as well as the decline in creditworthiness among borrowers. In addition to their reduced risk tolerance, some banks cited restrictions or costs related to their capital positions.

Perceptible inflows in consumer credit, too

While lending for house purchase moved sideways at a high level, banks recorded higher growth in consumer credit than in the previous quarter. This is consistent with the data provided by the banks surveyed by the BLS, which reported a further increase in demand for consumer credit and other lending in the second quarter. They attributed this almost exclusively to greater funding needs among households for the purchase of durable consumer goods. Furthermore, the banks responding to the BLS indicated that they had moderately tightened their credit standards for consumer credit and other lending in the second quarter.

Declining Eurosystem net asset purchases dampened inflows to securitised lending

Inflows to securitised lending to general government supported monetary growth to a lesser extent than it had in the previous two years. Following the end of net asset purchases under the PEPP at the end of March, the APP was also discontinued at the end of June. As a result, the Eurosystem significantly reduced its net purchases of government bonds on balance in the second quarter. However, as net bond issuance by euro area countries was relatively low in the reporting quarter due to seasonal factors, the Eurosystem's reduced exposure did not, in purely accounting terms, create any major gap in demand. In addition, commercial banks also purchased a moderate volume of government bonds on balance after having reduced their holdings over the past two years.

Net external asset position had further dampening effect on monetary growth

As in the preceding quarters, the MFI sector's net external asset position had a dampening effect on monetary growth. First, this was partly due to the fact that, on balance, nonresidents sold mainly shares and investment fund shares, but also short-term euro area government bonds. The driving factor behind this is likely to be the reduced attractiveness of investing in the euro area at present due to its geographical proximity to Russia as well as the higher yields abroad, especially in the United States and United Kingdom. While domestic non-banks also sold equity and long-term bonds from non-resident issuers in net terms, the euro area financial account balance vis-à-vis the rest of the world remained negative overall. Second, the current account balance, which usually has a supportive effect, continued to shrink due to trade barriers and increased costs of imports; based on the figures for April and May available thus far, it was also negative.

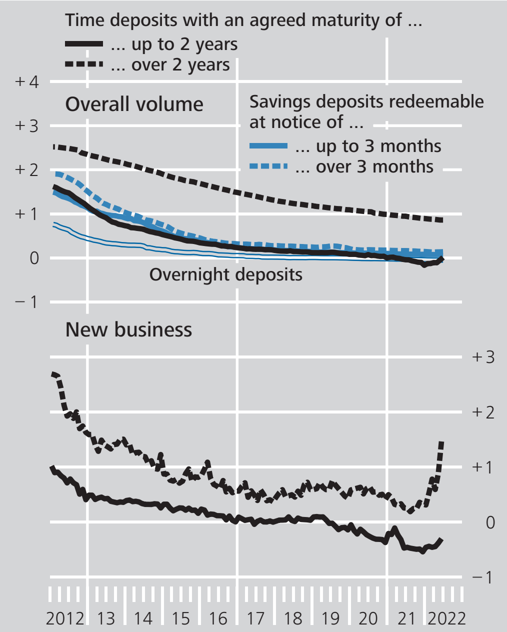
German banks' deposit and lending business with domestic customers

Deposit business clearly lost momentum

German banks' deposit business with domestic customers lost considerable momentum in the second quarter of 2022. Against the backdrop

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, seasonally adjusted

Item	2022 Q1	2022 Q2
Deposits of domestic non-MFIs[1]		
Overnight	56.6	0.4
With an agreed maturity of		
up to 2 years	18.5	13.1
over 2 years	− 3.1	− 6.6
Redeemable at notice of		
up to 3 months	− 1.0	− 2.9
over 3 months	− 1.1	− 0.7
Lending		
to domestic general government		
Loans	− 0.2	− 0.1
Securities	− 1.9	− 9.4
to domestic enterprises and households		
Loans[2]	57.6	58.9
of which: to households[3]	27.6	26.0
to non-financial corporations[4]	25.0	24.7
Securities	2.6	− 2.4

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

Deutsche Bundesbank

of the rising interest rate level and the steeper yield curve, holders hardly added to their overnight deposits on balance. Deposit business was driven solely by short-term time deposits remunerating at close-to-market rates, which grew perceptibly once again. Alongside increased expenditure for consumer and intermediate goods, the search for yield is also likely to have subdued growth in deposits. In an environment with significantly higher rates of inflation and rising interest rates, market participants are likely to have become more aware of the high opportunity costs of money holdings, which continue to be remunerated at very low rates (see the upper left-hand chart).

Inflows to deposits only for households and general government

Unlike in the preceding quarters, only households continued to build up their overnight deposits during the reporting quarter. However, this build-up was offset, on aggregate, by the fact that all other money-holding sectors markedly reduced their holdings of overnight deposits. As in the preceding quarter, the inflows to short-term time deposits were attributable to general government, which invested its surpluses in this form. As previously, the reduction in long-term time deposits was a result of portfolio shifts by financial corporations.

Renewed very strong momentum in lending business with non-banks

Banks' lending business with domestic non-banks maintained its extraordinary momentum in the second quarter of 2022. Loans to the domestic private sector, which grew steeply once again, were the main factor in this development. By contrast, lending to general government declined for the fifth quarter in succession.

Financing needs of non-financial sectors remained high

Looking at the growth in lending business, lending to households and non-financial corporations rose to almost the same extent. Both of these sectors sharply increased their stocks of loans despite sometimes considerable rises in lending rates. Part of the growth in corporate banking business was attributable to the Federal Government's new assistance loans for enterprises particularly affected by the war against Ukraine, which were disbursed directly by the KfW Group.

Heterogeneous drivers of demand among non-financial corporations

Loans to non-financial corporations grew for all maturities once again, with long-term loans recording the largest inflows. At present, there are various drivers for the high demand for loans among domestic enterprises. First, for enterprises with existing longer-term funding requirements, the desire to lock in interest rates is likely to still be playing a role. Second, short-term funding needs are currently elevated for many enterprises, in part due to the considerable increases in prices for some intermediate goods and working capital.

Loan demand driven partly by higher need for funds for inventories and working capital

The responses to the most recent BLS suggest that other factors were at play as well. German banks cited funding needs for inventories and working capital as a major reason for the increased demand for loans to enterprises. According to the bank managers, it also rose due to the fact that many enterprises expanded their inventories in light of the unstable supply chains and elevated uncertainty resulting from the war against Ukraine.

More restrictive lending policy in the corporate segment

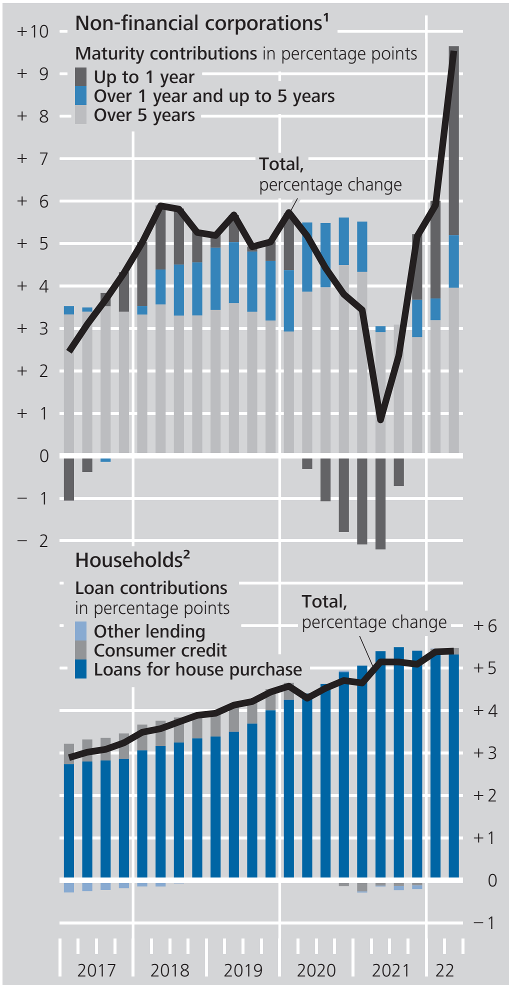
At the same time, the German banks responding to the BLS marginally tightened their corporate lending policies on balance and, for the first time in six quarters, also tightened their credit terms and conditions. They pointed to the rise in credit risk as the main reason for this. In particular, they cited the deteriorations in the general economic situation and economic outlook, partly due to the war against Ukraine, as well as sector-specific and firm-specific factors. According to the BLS reporting banks, the subdued financing environment on the money and bond markets had a marginally restrictive effect.

Demand for housing loans remained brisk despite significantly higher interest rates …

The largest contribution to growth in lending business among German banks continued to be made by lending to households. The key factor was again the sharp expansion in housing loans, which once again slightly exceeded their level from the previous quarter despite

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

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



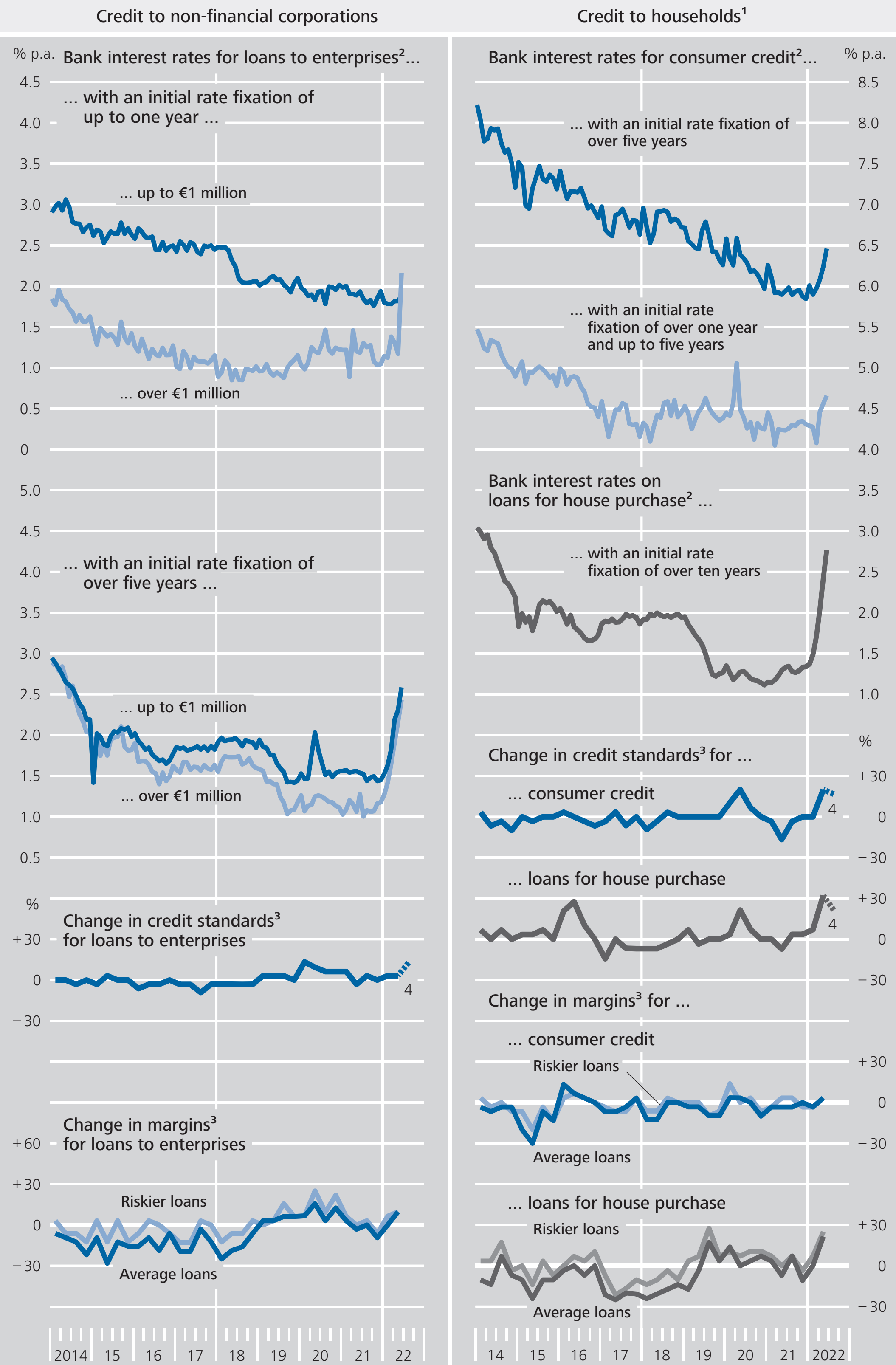
* Adjusted for loan sales and securitisation. **1** Non-financial corporations and quasi-corporations. **2** Including non-profit institutions serving households.
Deutsche Bundesbank

lending rates going up considerably. According to the MFI interest rate statistics, the interest rate on long-term loans for house purchase stood at 2.6% at the end of the second quarter and was thus significantly higher than at the end of the first quarter (1.7%). However, the annual growth rate of loans taken out for house purchase remained virtually unchanged at just under 7.0%.

… and considerably more restrictive lending policies

During the second quarter, credit standards for loans to households for house purchase were tightened, on balance, to the greatest extent recorded since the BLS was launched. According to the banks, credit terms and conditions

Banking conditions in Germany



1 Including non-profit institutions serving households. **2** New business. According to the harmonised MFI interest rate statistics. **3** According to the Bank Lending Survey; for credit standards: difference between the number of respondents reporting "tightened considerably" and "tightened somewhat" and the number of respondents reporting "eased somewhat" and "eased considerably" as a percentage of the responses given; for margins: difference between the number of respondents reporting "widened considerably" and "widened somewhat" and the number of respondents reporting "narrowed somewhat" and "narrowed considerably" as a percentage of the responses given. **4** Expectations for Q3 2022.

Deutsche Bundesbank

were also made considerably more restrictive. In addition, the rejection rate rose significantly compared with the previous quarter. The banks likewise justified these instances of tightening primarily on the grounds of a perceived increase in credit risk. This was caused in part by a downturn in the general economic situation and the gloomier outlook on the residential real estate market, as well as the decline in creditworthiness among borrowers. In addition, some banks also cited restrictions or costs related to their capital position.

Supply policy more restrictive in the consumer credit segment, too

According to the BLS, the standards and terms and conditions for consumer credit and other lending to households were also tightened in the second quarter of 2022. However, as in the previous quarter, net lending in the consumer credit segment saw slight inflows. BLS reporting banks judged that this was, in particular, a result of increased funding needs for the purchase of durable consumer goods.

Funding environment deteriorated somewhat for German banks

In response to the ad hoc questions in the July survey, German banks reported that their funding conditions had deteriorated somewhat compared with the previous quarter. This applies especially to funding via the short-term unsecured money market, funding via large-volume debt instruments, and the off-balance-sheet transfer of risks.

Level of NPL ratio had no noteworthy impact on changes in German banks' lending policies in H1 2022

The surveyed banks reported that the level of the NPL ratio (percentage ratio of (gross) non-performing loans to the gross book value of the loans) resulted in no changes to their lending policies in the first half of 2022. For the second half of 2022, too, banks are not expecting the NPL ratio to exert any meaningful influence on their lending policies.

Credit standards for residential real estate tightened in H1 2022

In the first half of 2022, German banks left credit standards largely unchanged in nearly all surveyed sectors of the economy. Only in the residential real estate sector did they report a discernible tightening. By contrast, they tightened their credit terms and conditions in all sectors. Banks are planning to tighten their standards and terms and conditions across sectors in the second half of the year. According to the banks, demand for credit increased in almost all sectors of the economy in the first half of the year, with the wholesale and retail trade being the only sector to see barely any uptick. Banks are more pessimistic overall about the second half of 2022. In particular, they are expecting a significant decline in the financial requirements of enterprises in the commercial and residential real estate sectors.

List of references

Banca d'Italia (2022a), Economic Bulletin, 2/2022, p. 42 and p. 44.

Banca d'Italia (2022b), Financial Stability Report, 1/2022, p. 25.

Banco de España (2022), Financial Stability Report, Spring 2022, pp. 74 f.

European Central Bank (2022), Press release of 21 July 2022, https://www.ecb.europa.eu/press/pr/date/2022/html/ecb.pr220721~973e6e7273.en.html