

Monetary policy and banking business

Monetary policy and money market developments

ECB Governing Council decides to raise key interest rates by a further 50 basis points in December ...

The Governing Council of the European Central Bank (ECB) decided at its December 2022 meeting to raise the three key ECB interest rates by 50 basis points and, based on the substantial upward revision to the inflation outlook, communicated that it expects to raise them further. The Governing Council judges that interest rates will still have to rise significantly at a steady pace to reach levels that are sufficiently restrictive to ensure a timely return of inflation to the 2% medium-term target. Keeping interest rates at restrictive levels will over time reduce inflation by dampening demand and will also guard against the risk of a persistent upward shift in inflation expectations.

... and again in February

February 2023 saw the Governing Council raise the key ECB interest rates yet again by 50 basis points. That decision took the interest rate on the deposit facility – currently the most important rate for money market rates – to the current level of 2.5% and the interest rates on the main refinancing operations and the marginal lending facility to 3% and 3.25%, respectively. The Governing Council furthermore reiterated its commitment to staying the course in raising interest rates significantly at a steady pace. In view of the underlying inflation pressures, the Governing Council intends to raise interest rates by another 50 basis points in March and will then evaluate the subsequent path of its monetary policy. In any event, future policy rate decisions will continue to be data-dependent and follow a meeting-by-meeting approach.

ECB Governing Council decides to reduce monetary policy securities holdings

The Governing Council also used its December 2022 meeting to announce principles for normalising the Eurosystem’s monetary policy securities holdings. The key ECB interest rates are the primary tool for setting the monetary

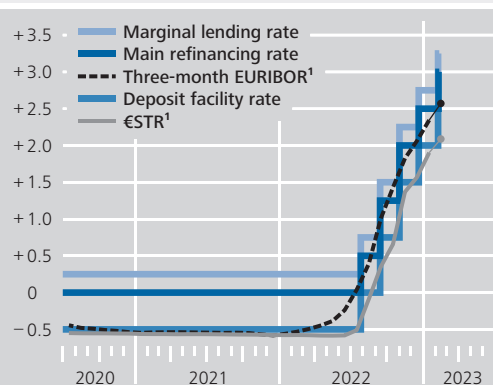
policy stance. From the beginning of March 2023 onwards, the asset purchase programme (APP) portfolio will decline at a measured and predictable pace, as the Eurosystem will not re-invest all of the principal payments from maturing securities. The decline will amount to €15 billion per month on average until the end of the second quarter of 2023 and its subsequent pace will be determined over time. The Governing Council will regularly reassess the pace of the APP portfolio reduction to ensure it remains consistent with the overall monetary policy strategy and stance, to preserve market functioning, and to maintain firm control over short-term money market conditions. At its February meeting, the Governing Council confirmed these parameters and decided on the technical modalities.¹ Reinvestments will be conducted broadly in line with current practice. The remaining reinvestment amounts will be allocated proportionally to the share of redemptions across each constituent programme of the APP.

Lastly, the Governing Council announced in December 2022 that it intends to review its operational framework for steering short-term interest rates by the end of 2023. This will provide

Review of framework for steering interest rates

Money market interest rates in the euro area

% p.a.



Sources: ECB and Bloomberg. ¹ Monthly averages. • = Average 1 to 10 February 2023.

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¹ For further details, see European Central Bank (2023).

Money market management and liquidity needs

In the reporting period from 2 November 2022 to 7 February 2023,¹ excess liquidity in the Eurosystem decreased significantly by a total of €578.5 billion to an average of €4,079.2 billion. This decline was mainly driven by repayments under the third series of targeted longer-term refinancing operations (TLTRO III). Following the repayment in November, average excess liquidity initially only fell by €89.5 billion to €4,568.1 billion in the seventh reserve maintenance period of 2022 (November-December), and, after the December repayment, decreased by a further €488.9 billion in the eighth reserve maintenance period of the year. The decline in total liquidity also led to the use of the deposit facility falling by €469.9 billion to €4,051.6 billion.

Compared with the sixth reserve maintenance period of 2022, liquidity needs in the euro area stemming from autonomous factors (see the table below) fell by €249.4 billion to an average of €1,999.6 billion in the eighth re-

serve maintenance period of that year. This counteracted an even sharper decline in excess liquidity. This development was chiefly attributable to a significant decrease in government deposits, which fell by €163.9 billion to €372.8 billion (with a decline of €49.8 billion to €77.8 billion taking place in Germany). Moreover, the reduction in the combined total of net foreign reserve assets and other factors, which are considered together owing to liquidity-neutral valuation effects, contributed to liquidity needs decreasing by €87.4 billion. Other factors comprise non-monetary policy deposits, which include deposits by foreign central banks, amongst other things. The steep decline in net banknote issuance from the previous reporting period ground to a halt, which is likely to be partly attributable to

¹ Here, the averages of the eighth reserve maintenance period of 2022 (December 2022-February 2023) are compared with the averages of the sixth reserve maintenance period of 2022 (September-November 2022).

Factors determining banks' liquidity*

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

Item	2022	2022/2023
	2 Nov. to 20 Dec.	21 Dec. to 7 Feb.
I. Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors		
1. Banknotes in circulation (increase: –)	+ 2.9	– 4.8
2. Government deposits with the Eurosystem (increase: –)	+ 44.2	+ 119.7
3. Net foreign assets ¹	+ 4.6	– 20.0
4. Other factors ¹	+ 37.5	+ 65.3
Total	+ 89.2	+ 160.2
II. Monetary policy operations of the Eurosystem		
1. Open market operations		
a) Main refinancing operations	– 2.1	– 0.7
b) Longer-term refinancing operations	– 171.7	– 643.8
c) Other operations	– 2.2	– 4.0
2. Standing facilities		
a) Marginal lending facility	+ 0.0	+ 0.1
b) Deposit facility (increase: –)	– 31.5	+ 469.9
Total	– 207.5	– 178.5
III. Change in credit institutions' current accounts (I. + II.)	– 118.2	– 18.2
IV. Change in the minimum reserve requirement (increase: –)	– 2.3	– 1.4

* 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.

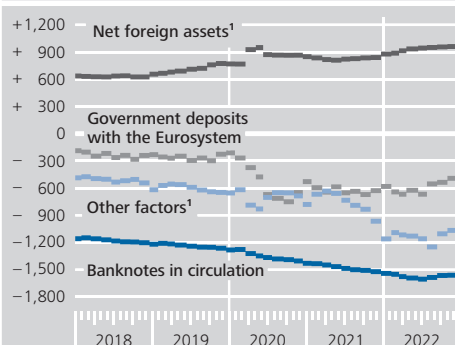
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the seasonal effect of the Christmas period. Net banknote issuance rose by €1.9 billion to €1,565.6 billion (in Germany, it increased by €3.4 billion to €898.0 billion). Over the period under review, the minimum reserve requirement in the Eurosystem climbed by €3.7 billion to €168.1 billion, which also marginally increased the need for central bank liquidity. In Germany, the reserve requirement went up by €2.2 billion to €46.5 billion.

Following the discontinuation of net purchases under the asset purchase programmes as of 1 July 2022, only reinvestments have been made under the asset purchase programme (APP) and the pandemic emergency purchase programme (PEPP). Overall, i.e. also taking account of the discontinued programmes, holdings of monetary policy assets decreased by €6.1 billion during the period under review as a result of revaluations and short maturities. As at 10 February 2023, the balance sheet holdings of the asset purchase programmes amounted to €4,945.2 billion (see the adjacent table). The average outstanding tender volume in the euro area decreased sharply by €818.3 billion to €1,304.5 billion during the observation period. Two of the TLTRO III special redemption dates that were agreed upon in October fell during the period under review (value dates: 23 November 2022 and 25 January 2023). Repayments totalling €296.3 billion and €62.7 billion were made in November 2022 and January 2023 respectively. In addition, regular repayments with a value date of 21 December 2022 were made in the amount of €447.5 billion. At the same time, the outstanding tender volume decreased by a further €51.9 billion when the TLTRO III.2 operations matured in December. Moreover, during the period under review, liquidity amounting to €1.1 billion was repaid at maturity under the pandemic emergency longer-term refinancing operations (PELTROs). As a result, no more repayments are outstanding. The volume in the regular main refinancing operations and three-month tenders remained at a very low level, with a slight rise in demand over the year-end period. In Germany, these early repayments caused the outstanding volume of all refinancing operations

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 10 Feb. 2023
Active programmes¹		
PSPP	- 3.3	2,590.5
CBPP3	+ 2.2	301.6
CSPP	- 0.4	343.4
ABSPP	- 1.6	20.8
PEPP	- 2.6	1,686.0
Completed programmes		
SMP	- 0.4	2.9
CBPP1	+ 0.0	0.0
CBPP2	+ 0.0	0.0

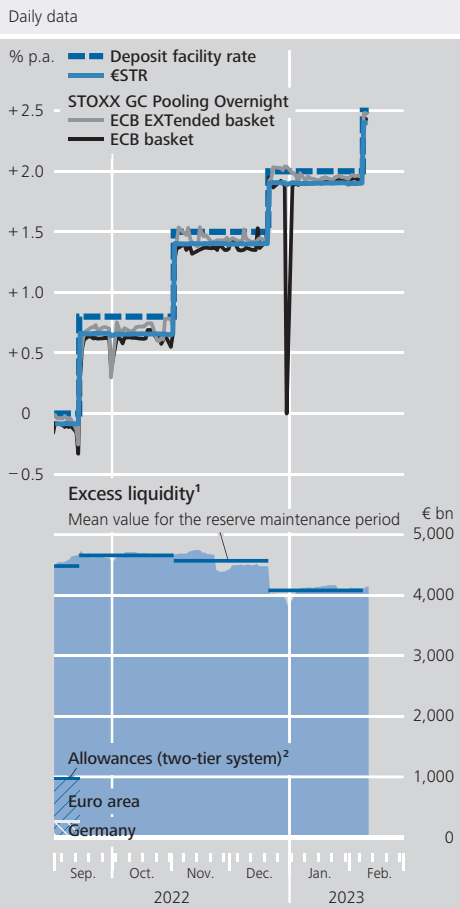
¹ Changes due to net purchases, maturities, reinvestments and amortisation adjustments.

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to fall by €169.0 billion to an average of €232.4 billion at last count. German banks' share in the outstanding volume of Eurosystem refinancing operations was thus equivalent to around 17.8%, which was 1.1 percentage points less than in the September-November 2022 reserve maintenance period.

After the Eurosystem raised its key interest rates by 75 basis points in the seventh reserve maintenance period of 2022 and by 50 basis points in the eighth reserve maintenance period of 2022, there was a corresponding rise in overnight rates in the euro money market (see the chart on p. 28).

Deposit facility rate, money market rates and excess liquidity



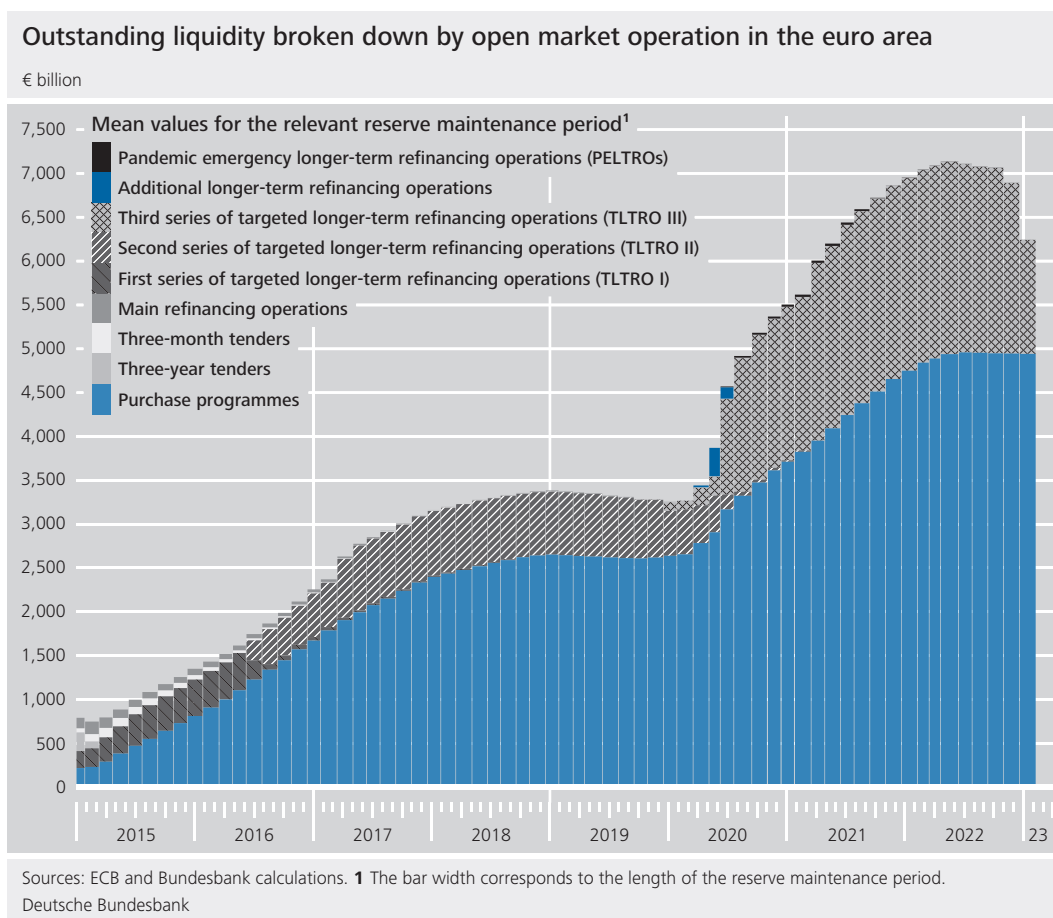
Sources: ECB, Eurex Repo and Bundesbank calculations. **1** Central bank balance minus the minimum reserve requirement plus the deposit facility. **2** With effect from 14 September 2022, the ECB Governing Council set the multiplier for the exemption allowance to zero.
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Over the period under review, the unsecured euro short-term rate (€STR) mirrored the policy rate increases almost exactly, standing at 1.40% and 1.90% on average in the respective reserve maintenance periods. The average spread between €STR and the deposit facility rate widened by 1 basis point to 10 basis points during the period under review. Following a substantial increase in turnover in the preceding observation period, average turnover rose by a further €2.7 billion to €66.5 billion in the seventh reserve maintenance period of 2022. There was a noticeable decline to €57.5 billion in the eighth reserve maintenance period of 2022, which was driven by lower levels of liquidity on public holidays and the last day of the year. At the

end of the year, turnover fell to €21.9 billion and €STR decreased by 1.5 basis points to 1.89%. However, the market returned to its usual level the next trading day.

In the secured money market, a significant rise in both transaction volumes and interest rates was seen on the GC Pooling trading platform. As a result, the spreads between both baskets and the deposit facility rate have been narrowing again since the summer of 2022. In the ECB basket, overnight trades were executed at an average of 1.37% in the seventh reserve maintenance period of 2022 and an average of 1.86% in the eighth reserve maintenance period of 2022, with the latter average being distorted by the decline on the last day of the year. Excluding this end-of-year effect, the average rate would have been 1.91% in the eighth reserve maintenance period of 2022. This would have decreased the 13 basis point spread to the deposit facility rate in the preceding period to 9 basis points. 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 1.45% in the seventh reserve maintenance period of 2022 and 1.96% in the eighth reserve maintenance period of 2022. No transactions took place on the last day of the year, meaning that the average was not distorted downwards. Following low turnovers of €0.7 billion in the ECB basket and €2.2 billion in the ECB EXTended basket during the seventh reserve maintenance period of 2022, liquidity-driven secured turnover on the GC Pooling platform rose substantially in the eighth reserve maintenance period of the year, to €4.1 billion and €3.9 billion respectively, although markedly lower turnover was recorded on public holidays and the last day of the year.

For the first reserve maintenance period of 2023, which is still ongoing, it can be seen that the rise in the Eurosystem's key interest rates is, once again, being almost fully passed on to the observed overnight rates.



information regarding the endpoint of the balance sheet normalisation process.

ergy and food remained at 5.2% in January. Other indicators of underlying inflation were also still high.

Inflation still far too high and projected to stay above target for too long

The December 2022 decisions came against the backdrop of inflation that is still far too high and projected to stay above the target for too long. Eurosystem staff once again significantly revised their inflation projections upwards in December. They saw average inflation reaching 8.4% in 2022 before decreasing to 6.3% in 2023. Inflation is projected to average 3.4% one year later, in 2024, and still come to 2.3% one year after that, in 2025. The Governing Council assessed that the risks to the inflation outlook were primarily on the upside in December. In February 2023, the Governing Council noted that the risks to the inflation outlook had become more balanced, especially in the near term, but were still tilted to the upside. Price pressures remained strong despite a decline in inflation to 8.5%, with the decline being mainly attributable to a renewed sharp drop in energy prices. Inflation excluding en-

The euro short-term rate (€STR) once again moved almost entirely in step with the two key interest rate hikes totalling 100 basis points during the reporting period, closing the period under review at 2.401%. The three-month EURIBOR likewise continued to rise significantly, ending the period at 2.654%, up by around 85 basis points on mid-November.

€STR rises in line with policy rate hikes

Money market forward rates are continuing to signal further key interest rate increases even after the Governing Council's February meeting. For the next monetary policy meeting in March, market participants are almost fully pricing in an interest rate step of 50 basis points. The money market forward curve is currently expected to peak in mid-2023 at around 3.5%, which is significantly (roughly 60 basis points) up on mid-November. The Governing Council's

Money market forward rates pricing in further interest rate steps

statement following the December 2022 meeting signalling further key interest rate increases at a steady pace is likely to have played a key role in this regard. Given the high uncertainty, however, the forward curve remained highly volatile, fluctuating primarily in response to incoming economic data as well as communications by the major central banks, the latter being used by market participants to continually reassess the future path of inflation.

More interest rate hikes expected, SMA shows

The ECB Survey of Monetary Analysts (SMA) conducted ahead of the February meeting also shows that more interest rate hikes are expected. Respondents to the survey conducted prior to the February meeting were likewise expecting a median interest rate hike of 50 basis points in March plus an interest rate step of 25 basis points in May, which would take the interest rate on the deposit facility to 3.25%.

Little change in securities holdings

Monetary policy securities holdings have seen little change since mid-November. Aggregate holdings reported under both purchase programmes are currently being influenced only by the smoothing over time of reinvestments and by the use of amortised cost accounting.² On 10 February, the Eurosystem was holding assets totalling €3,256.3 billion as part of the APP (see the box entitled “Money market management and liquidity needs” on pp. 26 ff. for a breakdown of the holdings by individual programme). The Eurosystem will not reinvest all of the principal payments from maturing securities as from the beginning of March, which means the APP portfolio will decline gradually. Asset holdings reported under the pandemic emergency purchase programme (PEPP) came to €1,686 billion on the same day. The Governing Council will continue to apply flexibility with regard to PEPP reinvestments, with a view to countering risks to the monetary policy transmission mechanism related to the pandemic.

Excess liquidity down markedly

Excess liquidity has fallen significantly since mid-November, dropping by around €575 billion to €4,157 billion at the end of the period under re-

view. The decline is mainly attributable to large voluntary repayments under the third series of targeted longer-term refinancing operations (TLTRO III). Modification of the TLTRO terms and conditions in October created noticeably stronger incentives to make voluntary early repayments. On aggregate, banks repaid around €806 billion ahead of schedule during the period under review. However, developments in autonomous factors had a counter-effect on excess liquidity (see the box on pp. 26 ff.).

Monetary developments in the euro area

With the monetary policy stance tightening, growth in the broad monetary aggregate M3 weakened sharply in the fourth quarter of 2022, with the annual growth rate falling significantly to 4.1% at the end of December. Tighter monetary policy drove up money and capital market yields, increasing the opportunity costs of holding money. This prompted investors to shift their portfolios both out of and within the monetary aggregate M3. From the perspective of the counterparts, a sharp decline in loans to the non-financial private sector crimped monetary growth as uncertainty surrounding the economic outlook plus higher financing costs in particular dampened enterprises’ and households’ demand for loans. Credit growth is also likely to have been subdued by the ongoing tightening of banks’ lending policies, which the latest Bank Lending Survey (BLS) found to have continued into the reporting quarter in the form of more restrictive credit standards. The banks surveyed by the BLS, meanwhile, mainly put the tightening down to what they saw as an increase in credit risk.

Monetary growth down in Q4

In terms of money holdings, there were continued portfolio shifts out of low-interest highly

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.

Shifts out of overnight deposits in particular into short-term time deposits

liquid deposits into higher-interest deposits with somewhat longer investment horizons (see the table on p. 32). In a particularly striking development, overnight deposits declined sharply, registering their first decline overall since spring 2011.³ The accumulation of cash holdings came to a standstill as well. Instead, investors – first and foremost non-financial corporations and households – added significantly to their stocks of short-term time deposits. Moreover, France saw substantial inflows into money market funds, a broadly popular form of investment in that country that had fallen out of favour during the low interest rate period. With market rates picking up as the Eurosystem raised its key interest rates, investments like money market funds and short-term time deposits came back into vogue as a source of returns compared with overnight deposits.

Banks' longer-term funding instruments in demand as well

Overall, however, the strong build-up of other short-term deposits failed to offset the sharp decline in overnight deposits, lowering the monetary aggregate M3 on balance. In part, this was because private non-banks invested to a degree in longer-term MFI sector liabilities, which do not count towards the money supply. Their demand centred around longer-term bank debt securities because of the significantly superior yields they offered over deposits.

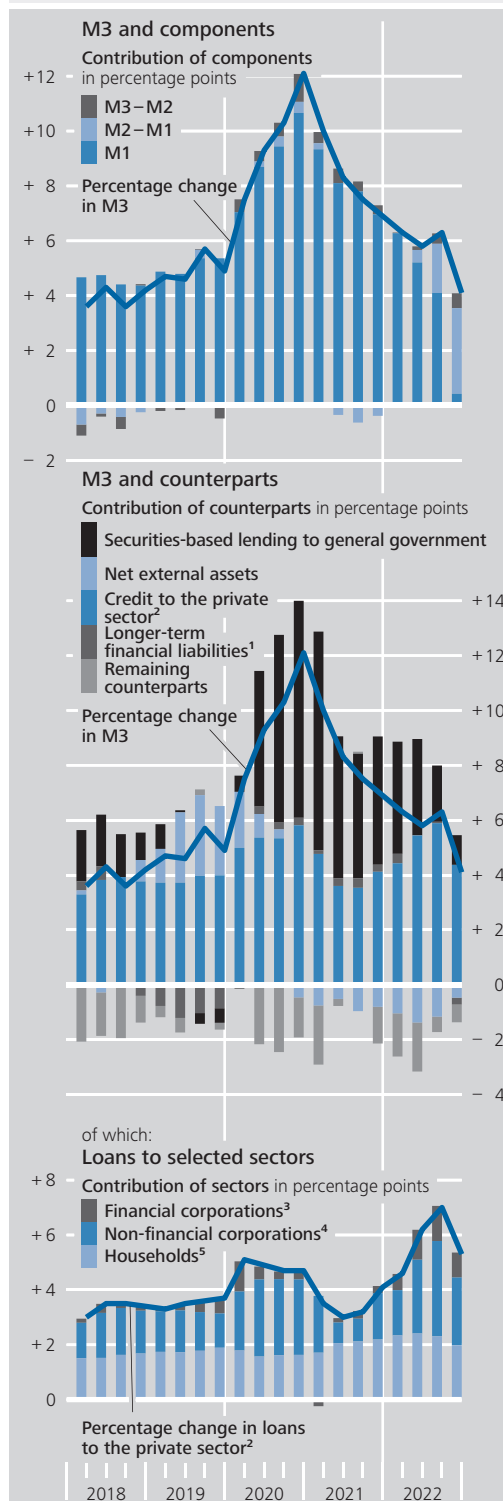
Net lending to non-financial corporations came to a standstill owing to demand and supply-side factors

Besides the increase in opportunity costs, another key factor driving the decline in the money supply in the fourth quarter was the sharp drop in loans to the euro area private sector. The turnaround was particularly pronounced in the case of loans to non-financial corporations, where the strong flows of net lending observed previously came almost to a standstill in the fourth quarter. Net lending contracted throughout the euro area in a reflection of two factors: first, the negative impact on loan demand of the increased cost of

³ The scale of this decline is distorted to a degree by a one-off effect. A clearing house placed a large temporary deposit with the Eurosystem in September and reversed it again in October; see European Central Bank (2022).

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.

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

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

Assets	Q3 2022	Q4 2022	Liabilities	Q3 2022	Q4 2022
Credit to private non-MFIs in the euro area	223.9	- 3.9	Holdings against central government ²	- 115.0	41.0
Loans	233.6	- 36.0	Monetary aggregate M3	341.3	- 78.7
Loans, adjusted ¹	238.0	5.5	Components:		
Securities	- 9.7	32.1	Currency in circulation and overnight deposits (M1)	128.0	- 358.9
Credit to general government in the euro area	- 36.4	45.8	Other short-term deposits (M2-M1)	182.4	225.3
Loans	1.9	4.8	Marketable instruments (M3-M2)	30.9	54.8
Securities	- 38.3	41.0	Longer-term financial liabilities	- 4.1	51.3
Net external assets	- 26.3	47.3	Capital and reserves	45.2	7.8
Other counterparts of M3	60.9	- 75.7	Other longer-term financial liabilities	- 49.3	43.6

* 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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funds and the uncertain outlook for the economy; and second, the continued tightening of credit standards identified by the BLS is also likely to be gradually having a dampening effect on lending. The downward movement was amplified by a one-off effect from Germany. The second and third quarters saw the KfW Group grant large-volume, government-guaranteed loans to enterprises from the energy sector to safeguard the energy supply, some of which were repaid in the fourth quarter (for further details see p. 35). These developments depressed the annual growth rate of loans to non-financial corporations in the euro area by 2½ percentage points in the quarter under review to 6.3% at year-end.⁴

Decrease in demand due to higher rates and lower financing needs related to fixed investment, BLS banks report

Responses by banks participating in the BLS substantiate the view that both a decline in loan demand and a decrease in the loan supply were behind the weakening of credit growth. For the first time since the first quarter of 2021, they saw firms' demand for loans decrease in the fourth quarter of 2022. BLS banks regarded the increase in the general level of interest rates and the decrease in financing needs related to fixed investment as the main factors dampening demand. Loan demand was impacted positively by higher financing needs related to inventories and working capital, though the impact here was smaller than in the previous two

quarters. BLS banks also observed a decrease in demand for long-term loans, while demand for short-term loans remained broadly unchanged.

With regard to lending policy, BLS data show that euro area banks tightened their credit standards again in the fourth quarter. The surveyed banks once again cited elevated credit risk as the main reason for these adjustments. In particular, they highlighted the deteriorated economic situation, the economic outlook as well as sector-specific and firm-specific factors. Regarding their own behaviour, banks reported a further decrease in their risk tolerance. In addition, the higher cost of funds and balance sheet constraints on the bank side also contributed to the tightening of credit standards.

According to BLS, credit standards in corporate business tightened again

In the case of loans to households, the slowdown observed since the second quarter of 2022 continued to intensify (see the chart on p. 33). In particular, issuance of loans for house purchase, which is the most significant component, fell sharply in the fourth quarter. Their annual growth rate declined to 4.4% at the end of the year, thus standing 1 percentage

Loans to households for house purchase again weaker than in previous quarters ...

⁴ The annual growth rate was also dampened by a base effect. Lending to non-financial corporations was unusually high in the fourth quarter of 2021 because of the end of the reference period for obtaining special interest rate conditions in the TLTRO III operations.

point lower than in the previous year despite the high level of inflation, which also affected construction prices. A major factor behind this decline is the development of interest rates on loans for house purchase, which had risen by 1½ percentage points over the same period. The BLS banks also observed a considerable slowdown in the demand for housing loans in the fourth quarter. They attributed this to the higher interest rate level, lower consumer confidence, and clouded outlook in the housing market.

... and credit standards tightened again according to BLS

Similarly to loans to enterprises, the BLS indicated that credit standards for loans to households for house purchase were also tightened again mainly as a result of elevated credit risk. This was attributable not only to the deterioration in the general economic situation and the bleaker outlook in the housing market, but also to the decline in borrowers' creditworthiness. In addition, some banks stated that other factors relevant for this tightening were reduced risk tolerance, higher cost of funds, and greater balance sheet constraints.

Net growth in consumer credit and other lending to households at a low level

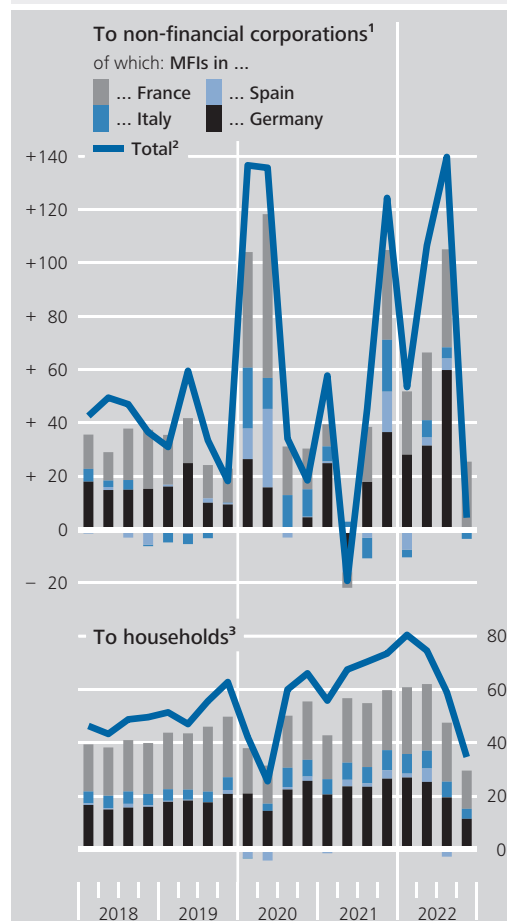
Net growth in consumer credit and other lending to households persisted at a low level in the fourth quarter of 2022. For the same period, the banks surveyed by the BLS reported a decline in newly negotiated consumer credit and other lending. According to the assessments by the BLS banks, the reasons for the decline in demand were, in particular, the higher general interest rate level, the decrease in consumer confidence, and a lower propensity to purchase. The respondent banks also reported that they had tightened their credit standards for consumer credit and other lending. As was the case for loans for house purchase, they attributed this mainly to their perception of increased credit risk.

Monetary growth supported by inflows to securitised lending

While lending saw hardly any expansion in the fourth quarter, securitised lending had a larger positive effect on monetary growth. The Eurosystem only reinvested principal payments, having discontinued its net purchases of govern-

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

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



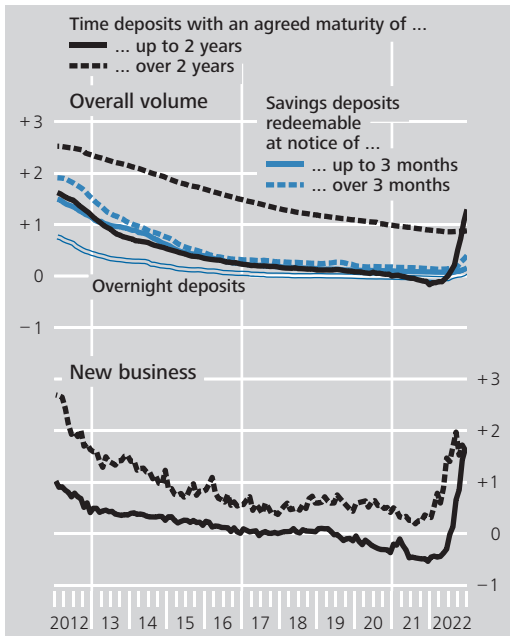
Sources: ECB and Bundesbank calculations. * Adjusted for loan sales and securitisation. ¹ Non-financial corporations and quasi-corporations. ² Also adjusted for positions arising from notional cash pooling services provided by MFIs. ³ Including non-profit institutions serving households.
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ment and corporate bonds in mid-2022. Euro area commercial banks, however, added to their holdings of securities. Amongst other factors, this reflected improved risk assessments in the capital market due to positive economic developments.⁵

⁵ An additional role was played by the comprehensive purchases of loan securitisations. In the fourth quarter of 2022, the banking sector took larger volumes of loans from their balance sheets, securitised them, and then partially repurchased these securitisations. On the consolidated balance sheet of the MFI sector, this is reflected in a difference between the adjusted and unadjusted loans to private non-MFIs as well as in an increase in securitised lending to private non-MFIs by the MFI sector (see the table on p. 32).

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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Recovery in current account balance supports MFI sector's net external position

In addition to net purchases of securities, inflows of funds from abroad supported monetary growth in the final quarter of the year. Against the background of slightly lower prices for energy and commodity imports, the euro area's current account balance vis-à-vis the rest of the world recovered and achieved a surplus in November. This contributed to perceptible growth in the MFI sector's net external position. Nevertheless, it remained lower than the high levels seen in 2019, i.e. before the outbreak of the COVID-19 pandemic. The financial account provided only weak positive impetus. Both residents and non-residents sold off securities from issuers in the respective other currency area on balance.

German banks' deposit and lending business with domestic customers

In contrast to the strong expansion of deposit business in the previous quarter, domestic customers' bank deposits grew only moderately in the fourth quarter. As was the case in the euro area as a whole, short-term time deposits remunerated at close-to-market interest rates once again saw significant growth. However, at the same time, overnight deposits and short-term savings deposits decreased considerably. It appears that investors are trying to benefit from the higher interest rates in the money market by rebalancing into time deposits. During the quarter under review, such behaviour was particularly evident among households and non-financial corporations. This development was driven by the fact that the interest rates on deposits with maturities of up to two years have risen significantly more sharply than those on overnight deposits and short-term savings deposits (see the adjacent chart). Regardless of the current interest rate conditions, domestic insurance corporations and pension funds continued to reduce their long-term bank deposits, as they have been doing for more than seven years now.

Deposit business characterised by rising interest rates and rebalancing

In the fourth quarter, German banks' lending business with domestic customers grew at a considerably weaker pace than in the previous quarters. However, it should be taken into account that the growth in loans to domestic non-banks had been exceptionally strong in the two preceding quarters due to the impact of the energy crisis and the government stabilisation measures. In this context, the current developments represent a countermovement to a certain degree. Alongside the loans to the domestic private sector, German banks also granted loans to domestic general government again for the first time in more than four quarters. Here, in addition to granting loans, they also increased their securities-based lending to general government.

Lending business with non-banks significantly weaker

Lending to non-financial corporations sees countermovement to exceptionally high level of lending

The significant slowdown in lending to the domestic private sector was mainly attributable to loans to non-financial corporations, which saw hardly any net growth during the reporting quarter. This was due to short-term loans declining sharply on balance. By contrast, medium-term and long-term loans to non-financial corporations continued to grow markedly in net terms. However, this growth was considerably weaker than it had been in the preceding quarters.

Slowdown in loans to non-financial corporations due to one-off effect, amongst others

The current weak growth in loans to non-financial corporations is a reflection of multiple factors. Alongside the tighter financing conditions and the uncertain macroeconomic environment – which, in and of itself, dampened the propensity to invest amongst enterprises – it was also largely a result of a one-off effect. This was caused, in particular, by the Federal Government’s purchase of equity capital in two major energy supply companies, which was conducted to ensure the continuity of the energy supply in Germany. Due to these government capital injections, parts of the loans previously granted by KfW Group were converted into general government equity, which explains part of the decline in loans.⁶ Furthermore, the easing in energy prices and global supply chains is also likely to have dampened enterprises’ short-term financing needs.

Higher lending rates and lower financing needs for fixed investment are important factors for decline in demand

The results of the BLS are largely in line with these assessments. For instance, for the fourth quarter, the surveyed banks reported that loan demand had fallen significantly on balance for the first time since 2013. The banks stated that the main reasons for the fall in demand were the higher general level of interest rates and the lower financing needs related to fixed investment. Alongside the high degree of uncertainty surrounding future economic developments, high inflation and the associated rises in the prices of investment projects are likely to have contributed to enterprises’ reluctance to invest. By contrast, financing needs related to inventories and working capital continued to provide positive stimulus for demand. Accord-

MFI* lending and deposits in Germany

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

Item	2022	
	Q3	Q4
Deposits of domestic non-MFIs¹		
Overnight	35.5	– 28.7
With an agreed maturity of up to 2 years	60.5	52.7
over 2 years	– 0.9	– 4.3
Redeemable at notice of up to 3 months	– 8.2	– 13.7
over 3 months	– 0.3	0.8
Lending		
to domestic general government		
Loans	0.1	2.8
Securities	– 7.8	1.6
to domestic enterprises and households		
Loans ²	78.9	20.4
of which: to households ³	19.3	11.3
to non-financial corporations ⁴	55.2	0.2
Securities	11.8	2.7

* As well as banks (including building and loan associations, but excluding the Bundesbank), monetary financial institutions (MFIs) here also include money market funds. 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

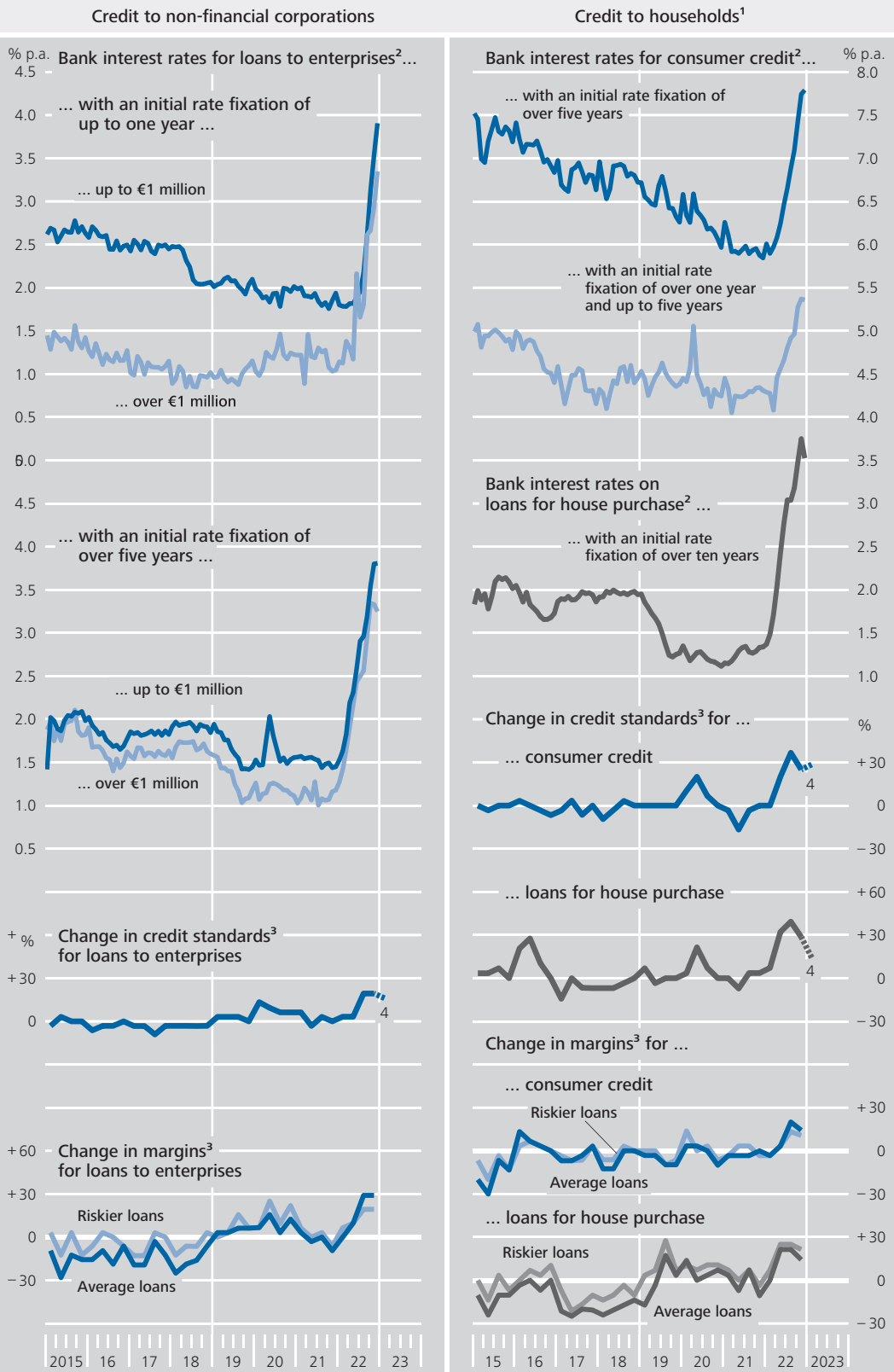
ing to bank data, higher working capital costs led to a rise in financing needs, especially amongst energy-intensive enterprises. However, the increase was significantly smaller than in the previous two quarters.

At the same time, the banks surveyed by the BLS tightened their credit standards for corporate lending on balance and also reported stricter credit terms and conditions overall. They pointed to the rise in credit risk as the main reason for this tightening. Similarly to the euro area as a whole, they attributed this primarily to the deterioration in the general economic situation and economic outlook, particularly as a result of the war against Ukraine and rising energy costs, but also to sector-specific and firm-specific factors. Moreover, for the first time since the start of the pandemic,

Credit standards and terms and conditions tightened once again

⁶ For details, see Federal Ministry of Finance (2022) and Federal Ministry for Economic Affairs and Climate Action (2022).

Banking conditions in Germany



1 Including non-profit institutions serving households. **2** New business. According to the harmonised MFI interest rate statistics. **3** According to the Bank Lending Survey; for credit standards: difference between the number of respondents reporting "tightened considerably" and "tightened somewhat" and the number of respondents reporting "eased somewhat" and "eased considerably" as a percentage of the responses given; for margins: difference between the number of respondents reporting "widened considerably" and "widened somewhat" and the number of respondents reporting "narrowed somewhat" and "narrowed considerably" as a percentage of the responses given. **4** Expectations for Q1 2023.

equity costs and banks' costs related to their capital positions also made a small contribution to the tightening of standards.

Growth in loans for house purchase continued to weaken

Lending business with domestic households continued to lose momentum in the fourth quarter. In this context, households exhibited considerably less demand for loans for house purchase than in the previous quarters. Furthermore, they markedly reduced their consumer and other borrowing overall. High inflation, the uncertainty surrounding the war against Ukraine and its repercussions, further increases in the cost of funds, and higher construction prices dampened household demand for bank loans.

Financing conditions for loans for house purchase significantly more restrictive

The bank supply side also had a restrictive impact again in the fourth quarter. Banks justified these stringent requirements primarily based on what they perceived to be elevated credit risk. In particular, the deterioration in the general economic situation and the economic outlook, as well as the bleaker outlook in the housing market, contributed to the tightening. Here, the restrictive impact stemming from the general economic situation and economic outlook was weaker than in the previous quarter, while the bleaker outlook in the real estate market had a greater effect in terms of tightening. However, the decline in borrowers' credit-worthiness also had a restrictive impact.

Demand for consumer credit and other lending also in decline

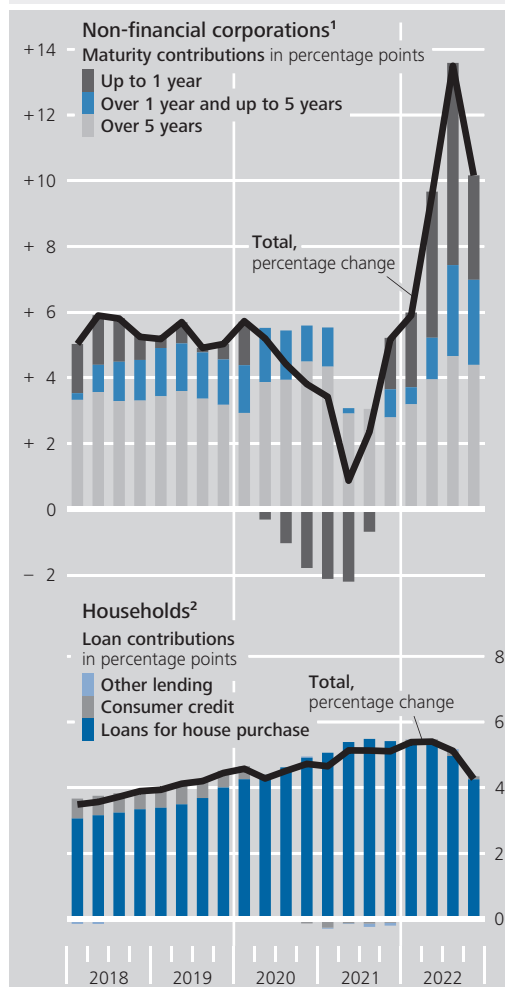
According to the BLS, the credit standards and terms and conditions for consumer credit and other lending to households were also tightened again in the fourth quarter of 2022. Moreover, as the cost of funds for consumer credit and other lending continued to rise significantly, there was a marked overall decline in households' propensity to purchase and, consequently, their demand for consumer credit and other lending.

Hardly any change in funding environment of German banks

For the fourth quarter of 2022, the surveyed German banks reported that there was little change in funding conditions overall.

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

The surveyed banks reported that the levels of their non-performing loan (NPL) ratios (percentage ratio of (gross) NPLs to the gross book value of loans) made a marginal contribution to the tightening of their lending policies in the second half of 2022. For the first half of 2023, banks are expecting their NPL ratios to have a slightly more restrictive impact on their lending policies.

Level of NPL ratio had marginal restrictive impact on changes to lending policy

In the second half of 2022, German banks tightened their lending policies in nearly all of the surveyed sectors of the economy. They set stricter standards, especially in the manufacturing sector and, within this sector, primarily for

Lending policies tightened in almost all surveyed economic sectors

energy-intensive enterprises, as well as in the residential real estate sector. The institutions are planning further tightening measures over

the next six months, though they stated that these are likely to be less severe than in the second half of 2022.

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