Monetary policy and banking business

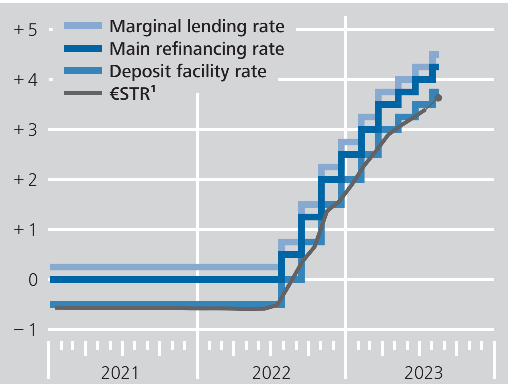
Monetary policy and money market developments

ECB Governing Council raises key interest rates by 25 basis points in both June and July

The ECB Governing Council decided to raise its three key interest rates by 25 basis points each at its monetary policy meetings in both June and July 2023. The interest rate on the deposit facility, which is currently the most significant for money market rates, thus now stands at 3.75%. The interest rates on the main refinancing operations and the marginal lending facility stand at 4.25% and 4.5%, respectively. These rate increases reflect the Governing Council's current assessment of the inflation outlook, the dynamics of underlying inflation, and the strength of monetary policy transmission. Despite a fall in actual inflation figures, the June projections indicate that inflation will remain too high for too long. Eurosystem staff revised the baseline path of headline inflation upwards compared with the projections from March. The new projections now see headline inflation at 5.4% for 2023, 3.0% for 2024, and 2.2% for 2025. The indicators of underlying price pressures remained strong, although some showed tentative signs of softening. Nevertheless, the projections for inflation excluding energy and food were likewise revised upwards compared with the March projections, especially for 2023 and 2024. The developments observed since the June meeting support the Governing Council's expectation that inflation will drop further over the remainder of the year, but will stay above the 2% target for an extended period. Furthermore, there are still upside risks to inflation, including from potential renewed upward pressure on prices for energy and food as well as a persistent rise in inflation expectations above the target. At the same time, however, the Governing Council believes that the rate increases thus far have been forcefully transmitted to financing conditions and have gradually had an effect on the economy as a whole. For instance, borrowing costs have increased steeply and growth in lending is slowing.

Key ECB interest rates and money market interest rates in the euro area

% p.a.



Source: ECB. **1** Monthly averages. • = Average 1 to 17 August 2023.

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Future interest rate decisions continue to follow data-dependent approach

The Governing Council's future decisions will ensure that the key ECB interest rates are set at sufficiently restrictive levels for as long as necessary to achieve a timely return of inflation to the 2% medium-term target. The Governing Council will continue to follow a data-dependent approach to determining the appropriate level and duration of restriction. In particular, interest rate decisions will therefore continue to be based on assessments of the inflation outlook, the dynamics of underlying inflation, and the strength of monetary policy transmission.

Further decisions: discontinuation of APP reinvestment and adjustment of minimum reserve remuneration

In June, the ECB Governing Council confirmed its announcement from May that it would stop reinvesting principal payments from maturing securities under the asset purchase programme (APP) as of July 2023. In July, the Governing Council additionally decided to set the remuneration of minimum reserves at 0%, rather than at the deposit facility rate, in order to improve the efficiency of its monetary policy. This decision will preserve the effectiveness of monetary policy while reducing the overall amount of interest that the Eurosystem needs to pay on

Money market management and liquidity needs

In the reporting period from 10 May 2023 to 1 August 2023,[1] excess liquidity in the Eurosystem decreased markedly by a total of €296.3 billion to an average of €3,716.7 billion, though it remained at a high level. The decline was driven by early repayments and maturing securities under the third series of targeted longer-term refinancing operations (TLTRO III). Shrinkage in the outstanding volume under the asset purchase programmes also contributed to bringing liquidity down, albeit to a lesser extent.

Compared with the second reserve maintenance period of 2023 (March-May 2023), liquidity needs in the euro area stemming from autonomous factors (see the table below) fell by €181.8 billion to an average of €1,664.1 billion in the fourth reserve maintenance period of 2023 (June-August 2023). Without this liquidity-providing development, excess liquidity would have contracted even more sharply. Liquidity needs were primarily lower on account of the marked decline of €106.2 billion in government deposits (of which €23.4 billion in Germany). The significant rise (€82.8 billion) in the combined total of net foreign assets and other factors, which are considered together owing to liquidity-neutral valuation effects, made a further major contribution to this development. The liquidity-providing effect was, inter alia, the result of the drop in other non-monetary policy deposits, which are counted among the other factors. These include, in particular, deposits from foreign central banks, which fell by €37.2 billion. The decline in deposits held in

1 The averages of the fourth reserve maintenance period of 2023 (June-August 2023) are compared here with the averages of the second reserve maintenance period of 2023 (March-May 2023).

Factors determining banks' liquidity*

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

Item	2023 10 May to 20 June	2023 21 June to 1 Aug.
I. Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors		
1. Banknotes in circulation (increase: –)	– 3.9	– 3.3
2. Government deposits with the Eurosystem (increase: –)	+ 104.2	+ 2.0
3. Net foreign assets[1]	+ 3.2	– 20.4
4. Other factors[1]	+ 63.9	+ 36.1
Total	+ 167.4	+ 14.4
II. Monetary policy operations of the Eurosystem		
1. Open market operations		
a) Main refinancing operations	+ 0.2	+ 9.3
b) Longer-term refinancing operations	– 17.2	– 418.5
c) Other operations	– 21.5	– 31.1
2. Standing facilities		
a) Marginal lending facility	+ 0.0	+ 0.0
b) Deposit facility (increase: –)	– 130.3	+ 422.0
Total	– 168.8	– 18.3
III. Change in credit institutions' current accounts (I. + II.)	– 1.1	– 4.2
IV. Change in the minimum reserve requirement (increase: –)	+ 1.0	– 0.3

* 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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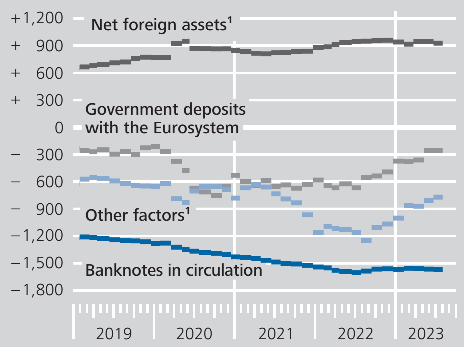
Autonomous factors in the Eurosystem*

€ billion, mean values for the relevant reserve maintenance period



Sources: ECB and Bundesbank calculations. * Liquidity-providing factors are preceded by a positive sign. Liquidity-absorbing factors are preceded by a 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 4 Aug. 2023
Active programmes[1]		
PSPP	− 41.1	2,498.8
CBPP3	− 3.1	295.5
CSPP	− 4.2	335.7
ABSPP	− 2.0	16.9
PEPP	− 2.3	1,672.6
Completed programmes		
SMP	+ 0.0	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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Germany amounted to €55.6 billion. Net banknote issuance in the Eurosystem rose overall by €7.2 billion to €1,567.0 billion, absorbing liquidity. In Germany, it went up by €7.6 billion to €907.9 billion. Over the period under review, the minimum reserve requirement in the Eurosystem fell by €0.7 billion to €165.1 billion, which marginally decreased the need for central bank liquidity. In Germany, the reserve requirement went down by €0.6 billion to €44.9 billion.

The scaling down of the asset purchase programme (APP) had the greatest impact on the change in purchase programmes. From March to June 2023, the portfolio was reduced on schedule by an average of €15 billion per month. Since 1 July 2023, reinvestments under the APP have been discontinued. At the same time, reinvestment in the pandemic emergency purchase programme (PEPP) has remained unchanged. Overall, holdings of monetary policy assets decreased by €52.7 billion in the period under review. As at 4 August 2023, the balance sheet holdings of the asset purchase programmes amounted to €4,822.4 billion (see the adjacent table).[2]

The average outstanding tender volume in the euro area decreased by €426.2 billion to €693.0 billion during the period under review. The maturity date for TLTRO III.4 and a voluntary early repayment option for TLTRO III.5-10 fell within the period under review, on 28 June. On that date, the repayment amount totalled €506.3 billion. The volume under the regular main refinancing operations and three-month tenders rose perceptibly after the TLTRO III.4 operations reached maturity, but has recently been declining again and has remained low overall. In Germany, the average outstanding volume of all refinancing operations fell by €56.9 billion to an average of €144.0 billion in the period under review. This was due to maturities and voluntary early repayments under TLTRO III in June, amounting to €68.8 billion. German banks' share in the outstanding volume of Eurosystem refinancing operations was around 21%, roughly 3 percentage points higher than in the second reserve maintenance period of 2023.

The Eurosystem's key interest rate hikes of 25 basis points each in May and June re-

2 In addition to the effects of reduced reinvestment under the APP, holdings were also shaped by revaluations and the smoothing of reinvestments under both programmes.

sulted in a correspondingly higher level of overnight rates in the euro money market in the third and fourth reserve maintenance periods of 2023 (see the adjacent chart). The marked decline in excess liquidity in the period under review had no discernible impact on overnight trading.

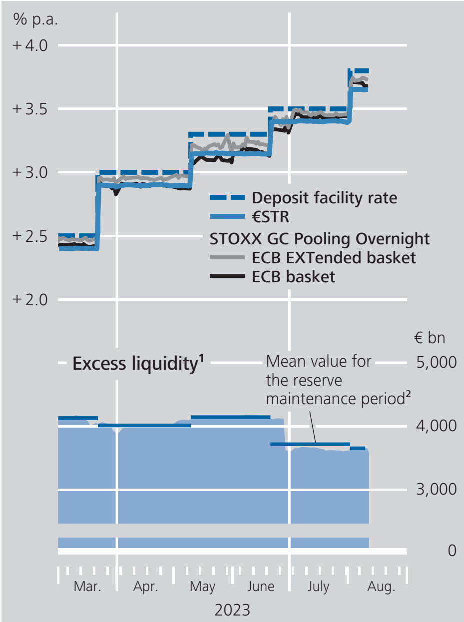
The unsecured euro short-term rate (€STR) mirrored all of the key interest rate increases over the period under review. With the spread between the €STR and the deposit facility rate remaining constant at 10 basis points, the €STR was 3.15% and 3.40% on average in the respective reserve maintenance period. The €STR volume averaged €62.9 billion in the third reserve maintenance period of 2023, before declining slightly to €61.7 billion in the subsequent reserve maintenance period.

In the secured money market, interest rates on the GC Pooling trading platform also mirrored key interest rate increases, albeit with their usual higher fluctuation range than in the €STR. Overnight transactions in the ECB basket were executed at an average of 3.13% in the third reserve maintenance period of 2023 and 3.42% in the subsequent reserve maintenance period. The spread over the deposit facility rate thus widened slightly to 12 basis points before falling back to 9 basis points. In the ECB EXTended basket, on the other hand, which has a broader selection of securities with lower rating requirements for concluding repo transactions, overnight trading took place at rates closer to the deposit rate – 3.21% and 3.45%, respectively – during the period under review. Average volumes traded in both baskets ranged between €4.0 billion and €5.0 billion in the period under review.

In the fifth reserve maintenance period of 2023, which is currently under way, it appears interest rate increases are again being fully passed on to the €STR.

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.

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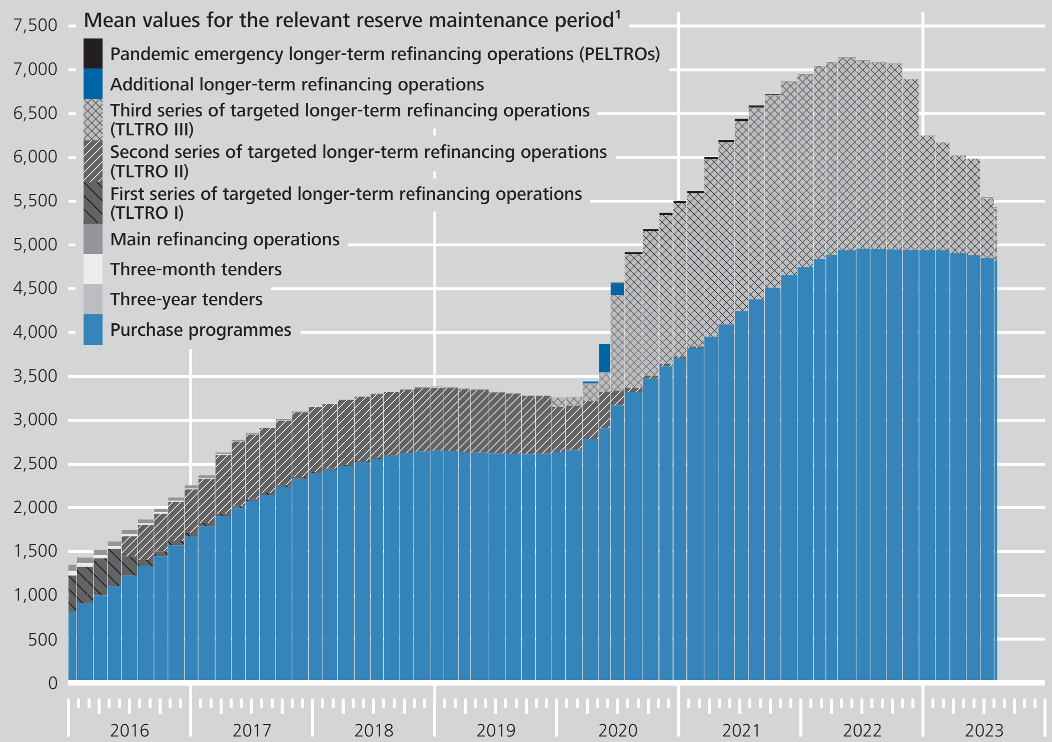
Outstanding liquidity broken down by open market operation in the euro area

€ billion



Sources: ECB and Bundesbank calculations. **1** The bar width corresponds to the length of the reserve maintenance period.
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reserves. It will maintain the current degree of control over the monetary policy stance and ensure the full pass-through of the interest rate decisions to money markets.

€STR moves in line with key interest rate hikes again

The euro short-term rate (€STR) once again moved almost entirely in line with the two key interest rate hikes totalling 50 basis points during the reporting period. It stood most recently at 3.657% and thus remained around 10 basis points below the deposit facility rate.

Money market forward rates no longer pricing in full interest rate step

Following the July meeting of the ECB Governing Council, money market forward rates declined slightly in response to the Governing Council's even greater emphasis on its data-dependent approach to future interest rate decisions. At present, market participants are not pricing in another full interest rate step of 25 basis points. The money market forward curve currently peaks in the fourth quarter of 2023 at around 3.8%, roughly 15 basis points up on the present level.

Respondents to monetary policy survey expect further rise in interest rates

The ECB Survey of Monetary Analysts (SMA) conducted ahead of the July meeting showed that the median analyst was still expecting two further interest rate hikes. The interest rate rise of 25 basis points in July was in line with expectations. For the monetary policy meeting in September, survey respondents expect one additional interest rate rise in the same amount. This would bring the deposit facility rate to 4%.

APP holdings reduced at faster pace since July

Monetary policy asset holdings continued to decline during the reporting period. As of the beginning of July, reinvestments under the APP were completely discontinued, which accelerated the reduction in asset holdings. On 11 August, the Eurosystem held assets totalling €3,146.9 billion under the APP (see the box on pp. 29 ff. for a breakdown of the holdings by individual programme). Asset holdings reported under the pandemic emergency purchase programme (PEPP) came to €1,675 billion on the same day. The ECB Governing Council will continue applying flexibility in reinvesting redemptions coming due in the PEPP portfolio, with a view to countering risks to the monetary policy transmission mechanism related to the pandemic. The aggregate holdings reported under both purchase programmes was influenced by the smoothing over time of reinvestments and by the use of amortised cost accounting.[1]

Sharp fall in excess liquidity, mainly due to TLTRO maturity

Excess liquidity has contracted significantly since mid-May, falling by around €453 billion. At last count, it came to €3,644 billion. This sharp decline was due mainly to the final maturity of the fourth operation of the third series of longer-term refinancing operations (TLTRO III) in June. Furthermore, voluntary early repayments for the still outstanding TLTRO III operations were made in the amount of approximately €29 billion. The complete discontinuation of reinvestments under the APP also caused excess liquidity to shrink further as of July. Excess liquidity was also influenced by the development of autonomous factors (see the box on pp. 29 ff.).

Monetary developments in the euro area

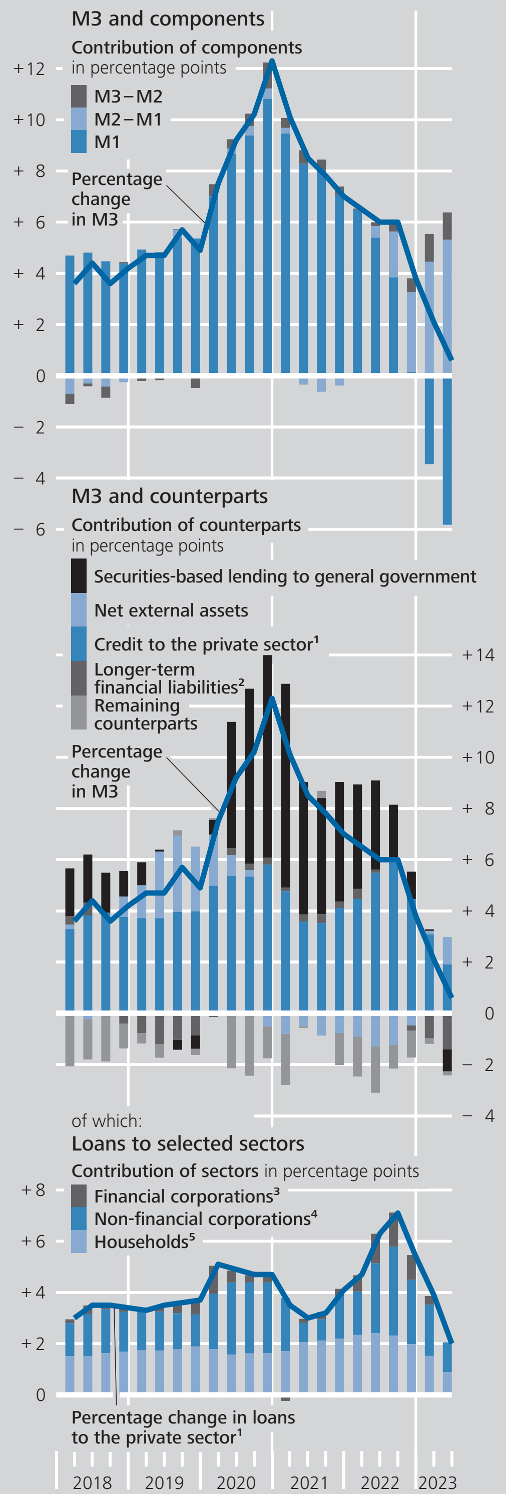
Monetary growth still in decline

As a result of the continued monetary policy tightening and weak economic developments, euro area monetary growth continued to decline in the second quarter of 2023, with the annual growth rate of the broad monetary aggregate M3 falling to just over ½% at the end of June (see the adjacent chart). The decrease applied particularly to overnight deposits, which continued to earn relatively low interest. Against the backdrop of the significant rises in money market interest rates and capital market yields, the money-holding sectors continued to shift their portfolios towards higher-yielding forms of investment, including to those outside of M3. On the supply side, the ongoing reduction of the Eurosystem's balance sheet com-

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

Monetary aggregates and counterparts in the euro area

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



Source: ECB. 1 Adjusted for loan sales and securitisation as well as for positions arising from notional cash pooling services provided by MFIs. 2 Denoted with a negative sign because, per se, an increase curbs M3 growth. 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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Consolidated balance sheet of the MFI sector in the euro area*

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

Assets	Q1 2023	Q2 2023	Liabilities	Q1 2023	Q2 2023
Credit to private non-MFIs in the euro area	– 5.9	8.0	Holdings against central government[2]	– 110.1	– 102.1
Loans	7.0	– 29.9	Monetary aggregate M3	– 66.5	– 44.3
Loans, adjusted[1]	4.0	2.6	Components:		
Securities	– 12.9	38.0	Currency in circulation and overnight deposits (M1)	– 375.1	– 258.0
Credit to general government in the euro area	– 80.5	– 87.1	Other short-term deposits (M2-M1)	249.3	188.3
Loans	– 19.8	– 9.7	Marketable instruments (M3-M2)	59.4	25.4
Securities	– 60.7	– 77.4			
			Longer-term financial liabilities	85.4	83.3
Net external assets	72.0	89.0	Capital and reserves	9.1	8.0
Other counterparts of M3	– 76.7	– 73.0	Other longer-term financial liabilities	76.3	75.3

* 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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bined with still weak bank lending caused monetary growth to slow. The subdued economic outlook, the associated credit risks, and the increased financing costs dampened lending to non-financial corporations and households. First, according to the most recent Bank Lending Survey (BLS), demand for credit fell in the reporting quarter once again. Second, the ongoing tightening of credit conditions contributed to weaker lending.

Portfolio shifts away from overnight deposits in particular and towards short-term time deposits

With regard to the components of the broad monetary aggregate M3, households and non-financial corporations in particular reduced their overnight deposits and instead invested in short-term time deposits (see the table above). Short-term savings deposits remained unattractive due to their lower interest rates compared with short-term time deposits. Households, which hold the largest share of savings deposits, therefore reduced their short-term savings deposits by a significant degree in the second quarter. Money market fund shares also continued to be purchased, albeit to a lesser extent than in the previous quarter.

Further rise in longer-term investments at banks

Over the quarter, there were again net outflows from M3, which were counterbalanced by net inflows to monetary capital. Overall, the increase in the items categorised under monetary capital exceeded the decrease in M3, meaning that, in arithmetical terms, the money-holding sector did not withdraw any funds from the monetary financial institutions (MFI) sector. Longer-term bank debt securities were especially demanded by investors, but longer-term bank deposits also benefited from portfolio reallocation. In the preceding quarters, the growth in these items was driven mainly on the demand side by investors' greater focus on earnings. The repayment of the TLTRO loans at the end of June 2023, which reduced some of the excess liquidity within the banking system, also recently increased the incentive for banks to make these forms of deposit more attractive.

Further reduction in securitised lending, especially to general government

Lending to non-MFIs in the euro area was negative on balance in the second quarter, too. This was mainly due to a net reduction in securitised lending to general government: the Eurosystem continued to shrink its APP portfolio and commercial banks also scaled back their holdings of euro area government bonds again. By contrast, commercial banks increased their holdings of private sector securities. However, the relatively large increase in bonds was overstated by extensive securitisations of residential real estate loans, especially by banks domiciled in France.[2]

Lending to domestic private sector weakened further …

Lending to the domestic private sector weakened further in the second quarter and saw hardly any growth over the previous quarter by the end of June. Loans to non-financial corporations stagnated, while loans to households even went down slightly. Among the four largest euro area Member States, banks in Germany and France recorded only small net inflows of credit, while the balances at banks in Italy and Spain continued to fall into negative territory (see the adjacent chart). The annual growth rate of corporate loans in the euro area, which was still at a multi-year high of just under 9% at the end of October 2022, dropped to 3% by the end of June.

… for both demand-side and supply-side reasons

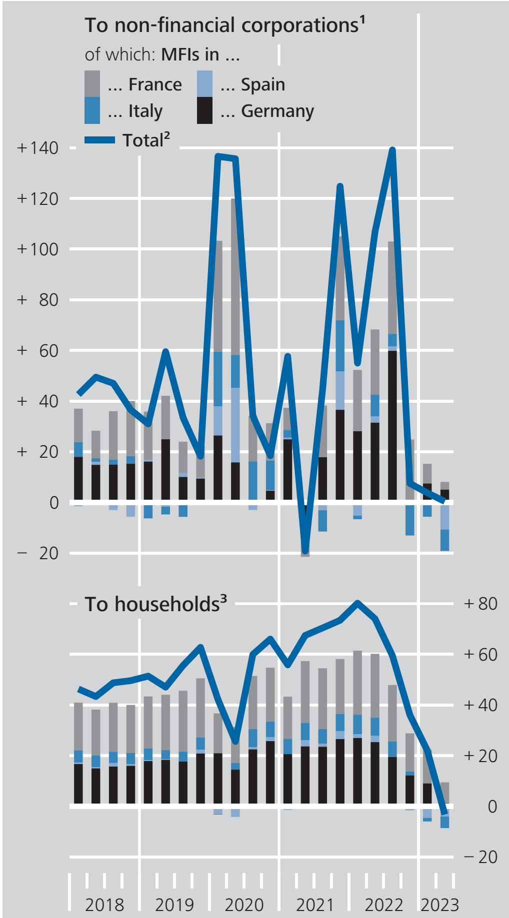
Loans to non-financial corporations lost traction mainly because of the weak state of the economy and the tightening of monetary policy in the euro area. These two factors dampened both loan supply and loan demand. Euro area banks raised their lending rates further as a way of accounting for their increased cost of funds and the deterioration in the risk situation. In addition, assuming the usual empirical relationships hold, the steps taken in the past quarters to tighten credit supply conditions are also likely to have had a dampening effect on lending. Enterprises, too, responded to the general economic situation, mainly repaying short-term loans on balance after these had become more costly in line with the increase in money market interest rates. Longer-term loans, on the other hand, recorded growth despite investment activity losing momentum. The rise in interest rates on these loans has been relatively modest thus far, which would suggest that a desire to lock in interest rates played a role here.

Rise in interest rates and declining financing needs related to fixed investment according to BLS explain sharp drop in demand

The BLS, too, identifies the unfavourable general economic situation as the main factor behind the weak loan growth. The surveyed banks expressed the view that the second quarter of 2023 had seen demand for loans to enterprises decline at the strongest rate ever recorded since the survey began in 2003. While respondents had been expecting demand to decline this quarter, they had not anticipated such a severe drop. The BLS banks cited the increase in the general level of interest rates and the decrease in financing needs related to fixed investment as the main reasons for the weaker demand for loans. In addition, demand was no

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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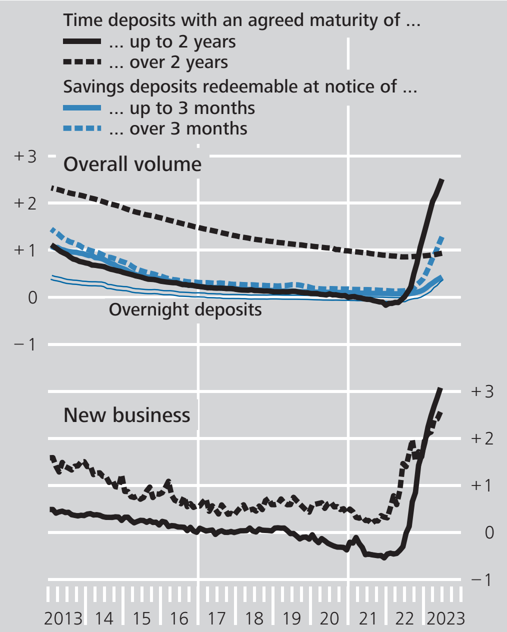
2 In this context, existing loans are bundled into tranches via securitisation vehicles and converted into bonds. For the banks involved, this reduces their loan holdings accordingly, whilst increasing their holdings of securitised loans. As the securitisation process is per se irrelevant for the economic assessment of lending, the table on p. 34 also includes a memo item that shows the adjusted change in lending to the private sector corrected for this effect.

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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longer buoyed by financing needs related to inventories and working capital, as it had been during the previous year.

Credit standards in corporate lending tightened again, but to a lesser degree than before

The BLS data suggest that euro area banks tightened their credit standards for loans to enterprises again in the second quarter, but to a lesser degree than in the previous quarter and in line with the expectations indicated in the latest round of the BLS. The surveyed banks reported yet again that elevated credit risk was the most important reason for their adjustments, citing above all their perception that the economic situation and outlook had deteriorated, as well as industry-specific and firm-specific factors. Inherently bank-related aspects, meanwhile, such as their risk tolerance and liquidity position, played less of a role in the tightening of credit standards than in previous quarters, the banks reported.

Lending to households weakened for the fifth consecutive quarter, recording a slight net outflow for the first time since the end of 2013.

Flows of loans to households for house purchase weaker again

Loans for house purchase, which are the most important component in terms of volume, played a major role in this. These loans posted no more than a marginal increase on the quarter after adjustment for loan sales and securitisation. While consumer credit more or less stagnated in the quarter under review, the relatively volatile loans categorised as “other lending” (including loans to sole proprietors) resulted in a net outflow on aggregate across all three categories in the second quarter. The continued slowdown was due in particular to the increased interest rates and continued high inflation in the euro area, which is having a negative effect on real disposable incomes and consumer confidence. Growth in loans to households for house purchase was additionally dampened by the persistently high house prices, even if the increase in these prices came to a halt recently in the euro area. Annual growth in loans to households contracted to 1¾% at the end of the quarter, leaving it almost 3 percentage points down compared with the multi-year high it reached one year earlier.

BLS banks report continued decline in demand for loans for house purchase …

Consistent with this observation, the banks surveyed as part of the BLS reported a continued decline in demand for housing loans in the euro area as well. They attributed this fall in demand primarily to the increased level of interest rates, the gloomy housing market prospects, and a decline in consumer confidence, but reported that demand had declined to a lesser extent than in previous quarters.

… and further tightening of credit standards at the same time

Banks’ lending policies were another drag on loan growth. The BLS banks reportedly tightened their credit standards for loans to households for house purchase, but to a lesser degree than in the previous quarter. In this loan category, too, the surveyed banks said that they had tightened their credit standards mainly on account of their perception that credit risk had increased. This assessment was based not only on the deterioration in the general economic situation and the bleaker housing market outlook, but also the decline in borrowers' creditworthiness.

German banks' deposit and lending business with domestic customers

Deposit business characterised by rebalancing as interest rates rise

With interest rates rising further, German banks' deposit business with domestic customers expanded markedly in the second quarter of 2023, after barely growing in the two preceding quarters. Inflows went primarily into short-term time deposits. The sharp rise in this type of deposit largely matched the net outflows out of overnight deposits and short-term savings deposits. These shifts, which were observed in households' deposits in particular and on a smaller scale in non-financial corporations' deposits as well, came about because the yield spread continued to widen between short-term time deposits remunerating at close-to-market rates and other short-term bank deposits (see the chart on p. 36). There was lively domestic demand for long-term bank deposits again in the current quarter, with households adding noticeably to their stocks of long-term time and savings deposits, and insurance corporations and pension funds scaling back their long-term time deposits far less substantially than has been typical in recent years. This development suggests that longer-term bank deposits are also beginning to benefit from rising interest rates.

Lending business with non-banks weakens further

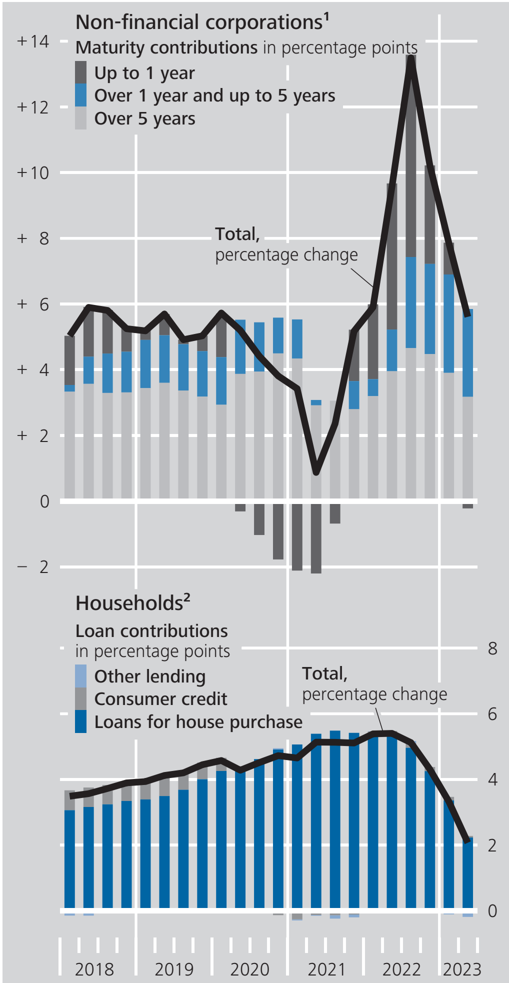
German banks' lending business with domestic customers weakened again significantly in the second quarter of 2023. First, growth in loans to the domestic private sector was noticeably weaker than in the previous quarters. Second, unlike in the last two quarters, lending to general government recorded marked outflows, particularly as a result of the distinct reduction in securitised lending.

Credit flows to the domestic private sector were weak due to sluggish lending to both households and non-financial corporations (see the chart above). Non-financial corporations made further net additions to their stocks of long-term loans, but to a somewhat lesser extent than in the previous quarters. They also redeemed short-term loans again on balance. Special factors, such as expiring government assistance loans, appear to have stopped exerting a particular influence in this regard because net flows followed similar patterns across different categories of banks.

Lending to non-financial corporations sees divergent developments in individual maturities

Loans* by German banks to the domestic private non-financial 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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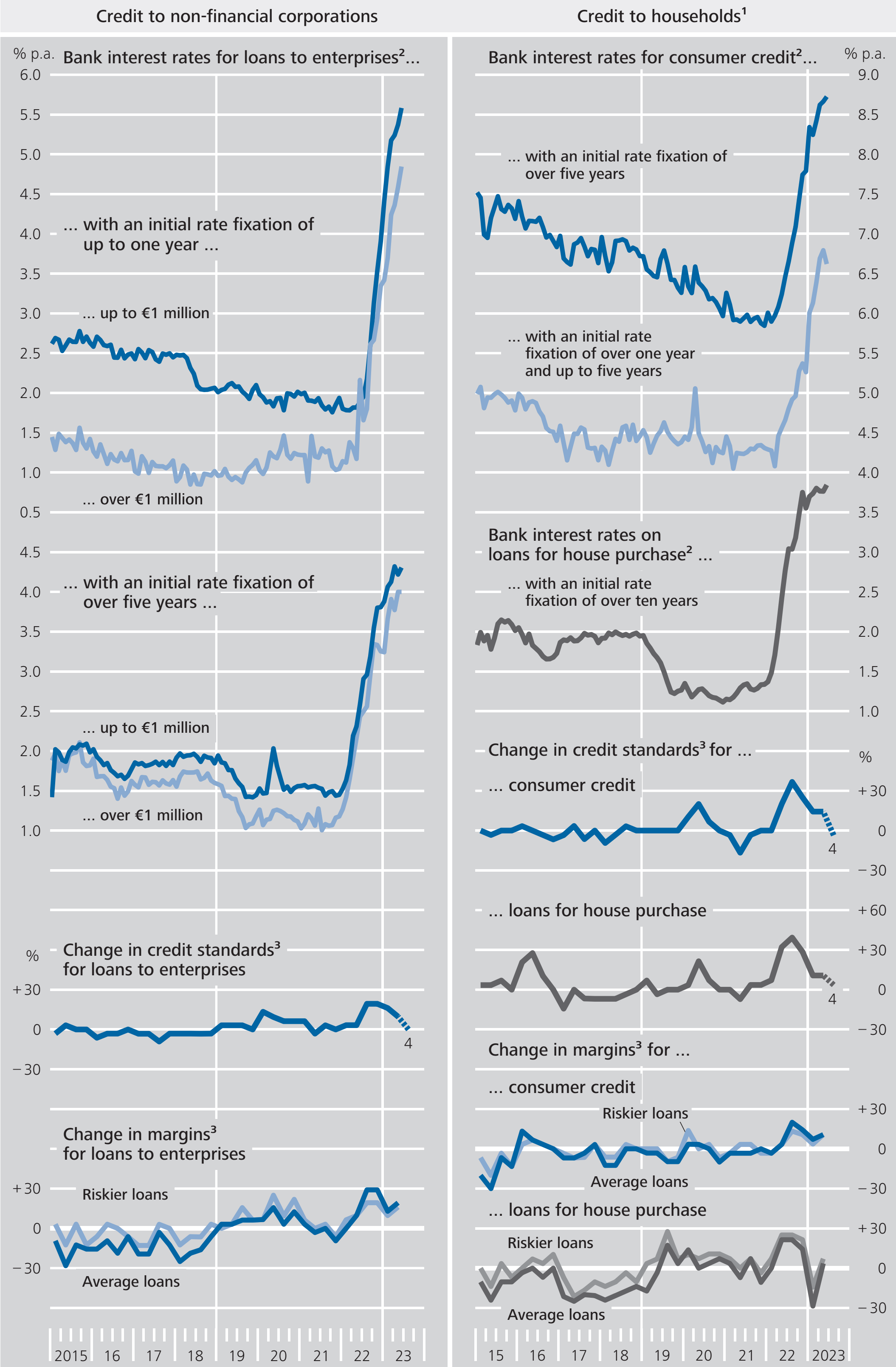
On aggregate, current developments in loans to non-financial corporations probably reflect multiple factors on both the demand and supply sides. In addition to the decline in enter-

Bank 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 2023.

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Slowdown in loans to non-financial corporations driven by demand-side and supply-side factors

prises' financing needs on the back of lower energy prices and receding supply bottlenecks, significantly higher lending rates and muted global economic activity are also likely to have weighed on loan growth.

Higher lending rates and declining financing needs related to fixed investment dampening demand

The banks interviewed as part of the BLS thus reported again that loan demand had declined in net terms in the second quarter of 2023. Although demand dropped in all the sectors surveyed, the largest decline over the past six months was in the real estate sector. The banks mainly attributed this fall in demand to the higher general level of interest rates and the decline in financing needs related to fixed investment. For the first time since 2019, financing needs related to inventories and working capital no longer propped up demand, but had a broadly neutral impact on it overall.

BLS credit standards tightened again, but to a lesser degree than in the previous quarter

On the supply side, the banks surveyed by the BLS tightened their credit standards for corporate lending on balance again at the same time – but to a lesser degree than in the previous quarter – and also reported tighter credit terms and conditions overall. The banks cited their reduced risk tolerance and elevated credit risk as the main reasons for their more restrictive lending policy stances. The more restrictive credit terms and conditions mainly took the shape of wider margins. While the real estate sector was hit disproportionately hard by the tightening of lending policies over the past six months, restrictive adjustments were made in all the other sectors covered by the BLS as well. Leaving aside the real estate sector, this tightening was also comparatively strong in construction (excluding real estate) and energy-intensive manufacturing. By contrast, banks tightened their credit standards and credit terms and conditions less severely in the services sector (excluding financial services and real estate) and in the wholesale and retail trade sector.

The German BLS banks reported that, over the past 12 months, climate-related risks and measures to cope with climate change had had a restrictive impact on their policies for loans to enterprises that make a relatively sizeable contribution to climate change. Over the next 12 months, the banks are planning to tighten their lending policies more sharply in connection with the impact of climate change. At the same time, the impact of climate change, taken in isolation, stimulated corporate demand for loans from German banks. The banks attributed the positive impulses to the fiscal support for measures to cope with climate change and also to increased financing needs related to investment and corporate restructuring in connection with climate change. The banks are expecting the topic of climate change to contribute to an increase in demand over the next 12 months, too.

Climate-related risks and measures to cope with climate change dampen loan supply

MFI* lending and deposits in Germany

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

Item	2023 Q1	2023 Q2
Deposits of domestic non-MFIs1		
Overnight	– 76.6	– 49.2
With an agreed maturity of		
up to 2 years	99.1	91.1
over 2 years	2.7	3.2
Redeemable at notice of		
up to 3 months	– 24.9	– 30.4
over 3 months	3.7	6.1
Lending		
to domestic general government		
Loans	0.9	– 0.1
Securities	– 0.6	– 2.4
to domestic enterprises and households		
Loans2	18.7	3.8
of which: to households3	8.7	1.1
to non-financial corporations4	2.1	3.7
Securities	0.3	5.4

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

Growth in loans to households weak due to declining loan demand …

Lending business with domestic households came almost entirely to a standstill in the second quarter. Households reduced their bank debt taken out for consumption and other purposes markedly and exhibited only minimal demand for housing loans. High inflation, the persistently high construction prices, and further increases in the costs of funds dampened household demand for construction work and bank loans.

… and more restrictive lending policy

According to the BLS, the bank supply side also had a restrictive impact in the second quarter. The surveyed banks reported that restrictive adjustments were made on balance to their credit standards and terms and conditions for loans to households for house purchase. The banks attributed the stricter requirements primarily to the gloomy housing market prospects and their lower risk tolerance.

The BLS banks tightened their credit standards and terms and conditions for consumer credit and other lending to households as well in the second quarter of 2023. In this loan category, too, the tightening was primarily a result of increased credit risk and lower risk tolerance.