Monetary policy and banking business

Monetary policy and money market developments

ECB Governing Council raises key interest rates by 25 bps in September

At its monetary policy meeting in September 2023, the ECB Governing Council decided to raise its three key interest rates by 25 basis points each. The interest rate on the deposit facility, which is currently the most significant for money market rates, now stands at 4%. The interest rates on the main refinancing operations and the marginal lending facility stand at 4.5% and 4.75%, respectively. The hike in interest rates is intended to reinforce progress towards a timely return of inflation to the medium-term target of 2%. This decision reflected the Governing Council's current assessment of the inflation outlook, the dynamics of underlying inflation, and the strength of monetary policy transmission. Whilst actual inflation continued to decline, the September projections – like the previous ones – still expect it to remain too high for too long. The new projections now put headline inflation at 5.6% for 2023, 3.2% for 2024, and 2.1% for 2025. Compared with the June projections, the ECB's experts have thus revised the path of headline inflation upwards for both 2023 and 2024, and slightly downwards for 2025. Although most of the indicators for the underlying price pressures had started to ease, they remained high. The projections for inflation excluding energy and food were revised marginally downwards compared with the June projections. The Governing Council assessed that financing conditions had tightened further and were increasingly dampening demand, which is an important factor in bringing inflation back to target.

Future interest rate decisions continue to follow data-dependent approach

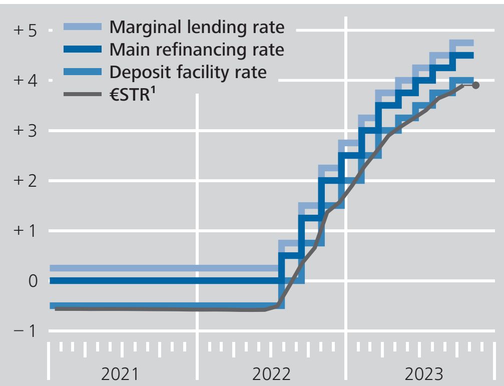
On the basis of its assessment in September, the ECB Governing Council held that, thanks to the interest rate hikes, the key interest rates had reached levels that would make a substantial contribution to the timely return of inflation to target. For this to happen, these key interest rate levels would have be maintained for a sufficiently long duration. 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 continue to be based on assessments of the inflation outlook, the dynamics of underlying inflation, and the strength of monetary policy transmission.

Key interest rates unchanged in October

In October 2023, the ECB Governing Council left its key interest rates unchanged for the first time since it began raising interest rates in July 2022. Incoming information since the September meeting has broadly confirmed its assessment of the medium-term inflation outlook. In September, there was a marked decline in the rate of inflation, which was attributable in part to strong base effects. Most measures of underlying inflation also continued to decline. However, the Governing Council still expects inflation to stay too high for too long. Furthermore, the upside risks to inflation from previous months remain. These risks include a lasting rise in inflation expectations above the ECB's target and higher than anticipated increases in wages or profit margins. In addition, the heightened geopolitical tensions could drive up energy prices in the near term, while

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

% p.a.



Source: ECB. **1** Monthly averages. • = Average 1 to 10 November 2023.

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Money market management and liquidity needs

In the reporting period from 2 August 2023 to 31 October 2023,[1] excess liquidity in the Eurosystem decreased by a total of €129.3 billion to an average of €3,587.4 billion, though it remained at a high level. The decline was driven mainly by early repayments and maturing securities under the third series of targeted longer-term refinancing operations (TLTRO III) as well as the decrease in the outstanding volume under the asset purchase programmes.

Compared with the fourth reserve maintenance period of 2023 (June-August 2023), liquidity needs in the euro area stemming from autonomous factors (see the table below) fell by a significant €124.6 billion to an average of €1,539.6 billion in the sixth reserve maintenance period of 2023 (September-October 2023). Without this liquidity-providing development, excess liquidity would have contracted even more sharply. The significant rise of €80.7 billion in the combined total of net foreign assets and other factors, which are considered together owing to liquidity-neutral valuation effects, was the main factor behind the declining liquidity needs. This was due inter alia to the fall in non-monetary policy deposits, which are included in the other factors. These include, in particular, deposits from foreign central banks, which decreased by €34.6 billion. Deposits held in Germany fell by €20.2 billion. In addition, the €31.6 billion decline in government deposits (with Germany accounting for €21.2 billion of that number) and the €12.3 billion drop in banknotes in circulation in the Eurosystem to €1,554.7 billion likewise had a liquidity-

1 The averages of the sixth reserve maintenance period of 2023 (September-October 2023) are compared with the averages of the fourth reserve maintenance period of 2023 (June-August 2023).

Factors determining banks' liquidity*

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

Item	2023	
	2 Aug. to 19 Sep.	20 Sep. to 31 Oct.
I. Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors		
1. Banknotes in circulation (increase: –)	+ 2.8	+ 9.5
2. Government deposits with the Eurosystem (increase: –)	+ 31.9	– 0.2
3. Net foreign assets[1]	– 3.5	+ 6.9
4. Other factors[1]	+ 36.7	+ 40.5
Total	+ 67.9	+ 56.7
II. Monetary policy operations of the Eurosystem		
1. Open market operations		
a) Main refinancing operations	– 5.3	+ 2.5
b) Longer-term refinancing operations	– 81.0	– 85.6
c) Other operations	– 41.8	– 43.3
2. Standing facilities		
a) Marginal lending facility	+ 0.0	+ 0.0
b) Deposit facility (increase: –)	+ 57.0	+ 70.0
Total	– 71.1	– 56.4
III. Change in credit institutions' current accounts (I. + II.)	– 3.1	+ 0.3
IV. Change in the minimum reserve requirement (increase: –)	– 0.2	+ 0.7

* 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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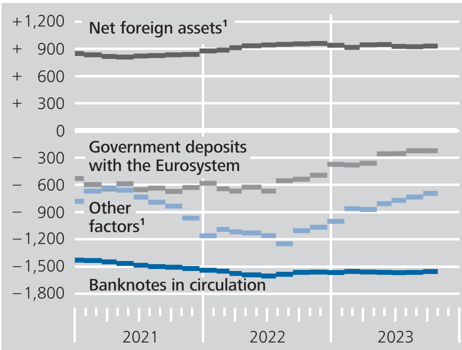
providing effect. In Germany, meanwhile, net banknote issuance rose by €4.9 billion to €912.8 billion. Over the period under review, the minimum reserve requirement in the Eurosystem fell by €0.6 billion to €164.5 billion, marginally decreasing the need for central bank liquidity. In Germany, the reserve requirement remained unchanged at €44.9 billion. Minimum reserves held with the Eurosystem were remunerated at 0.00% for the first time in the sixth reserve maintenance period of 2023. This did not change the manner in which institutions went about meeting their minimum reserve requirements on aggregate either in Germany or in the euro area as a whole. Of the central bank liquidity of euro area banks, 95% (96% in Germany) was held in the deposit facility.

The average outstanding tender volume in the euro area decreased by €168.8 billion to €523.5 billion during the period under review. The maturity date for TLTRO III.5 and a voluntary early repayment option for the TLTRO III.6 to TLTRO III.10 operations fell within the period under review, on 27 September 2023. A total of €101.0 billion was repaid on that date. The volume under the regular main refinancing operations and three-month tenders rose slightly for a time after the TLTRO III.5 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 €46.4 billion to €97.6 billion in the period under review. This was mainly due to maturities and voluntary early repayments under the TLTRO III operations in September, amounting to €41.2 billion. German banks' share in the outstanding volume of Eurosystem refinancing operations thus came to around 19%, which was roughly 2 percentage points lower than in the fourth reserve maintenance period of 2023.

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 3 Nov. 2023
Active programmes[1]		
PSPP	− 64.4	2,424.9
CBPP3	− 5.6	287.5
CSPP	− 7.7	327.8
ABSPP	− 2.1	14.4
PEPP	− 5.2	1,667.6
Completed programmes		
SMP	+ 0.0	2.4
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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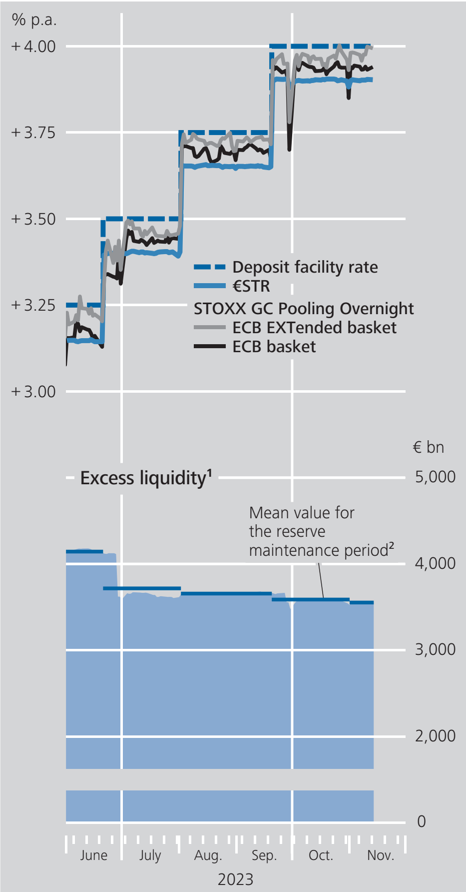
The scaling down of the asset purchase programme (APP) portfolio had the greatest impact on the overall amount of securities held for monetary policy purposes. Since 1 July 2023, reinvestments under the APP have been discontinued, while reinvestments under the pandemic emergency purchase programme (PEPP) have remained unchanged. Overall, holdings of monetary policy assets decreased by €85.0 billion in the period under review. As at 3 November 2023, the balance sheet holdings of the asset purchase programmes amounted to

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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€4,724.6 billion (see the table on p. 27) and thus remained at a high level.[2]

The Eurosystem's key interest rate hikes of 25 basis points each in July and September 2023 resulted in a correspondingly higher level of overnight rates in the euro money market in the fifth (August-September) and sixth reserve maintenance periods of 2023. Overnight rates were not affected, on the other hand, by maturities and repayments of TLTRO III operations or by the remuneration of government deposits with the Bundesbank being reduced to 0% as of 1 October 2023.

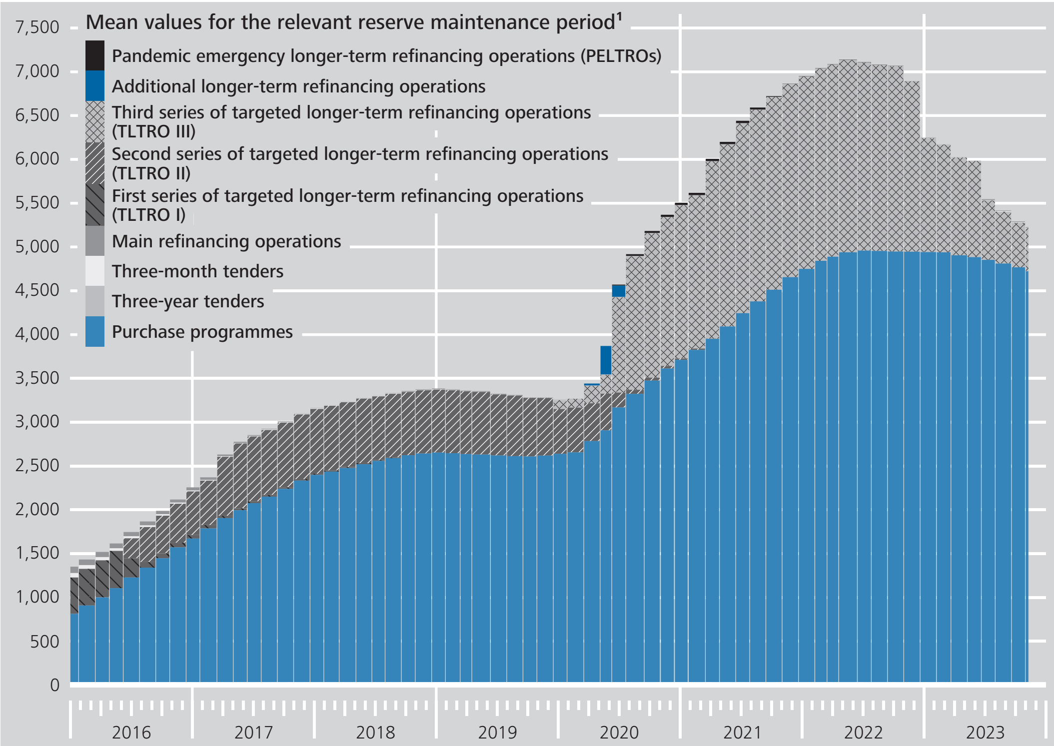
The unsecured euro short-term rate (€STR) mirrored all of the key interest rate increases over the period under review. With the spread over the deposit facility rate remaining constant at 10 basis points, the €STR stood at 3.65% and 3.90% on average in the respective reserve maintenance periods. The slight decline in transaction volumes that was already in evidence in the previous reporting period continued, with the €STR volume averaging €60.1 billion in the fifth reserve maintenance period of 2023 and €58.2 billion in the sixth. End-of-month effects had a stronger impact on the €STR in the sixth reserve maintenance period than in the past, with day-on-day declines of 2.6 basis points at end-September and 1.7 basis points at end-October.

Secured overnight transactions on Eurex Repo's GC Pooling trading platform saw the spread over the deposit facility rate decline again during the period under review. ECB basket transactions were traded at an average of 3.70% in the fifth reserve maintenance period of 2023 and of 3.93% in the sixth. By contrast, overnight rates in the ECB EXTended basket, which has a broader selection of securities with lower rating requirements for concluding repo transactions, remained closer to the deposit facility rate, standing at 3.73% and 3.96%, respectively. The spread between the ECB basket and the EXTended basket was narrower than in the previous period under review, at 3 basis points. Trading volumes averaged €5.0 billion in the ECB basket and €4.6 billion in the ECB EXTended basket in the period under review, up on the previous reporting period. The interest rates mentioned above remained virtually unchanged as the new reserve maintenance period (the seventh, for November-December 2023) got underway.

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

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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making the medium-term outlook more uncertain. The Governing Council therefore also reiterated that it would continue to take a data-dependent approach to future interest rate decisions.

€STR moves in line with September key interest rate hike

The euro short-term rate (€STR) once again moved almost entirely in line with the key interest rate hike of 25 basis points in September. It stood most recently at 3.903% and thus remained around 10 basis points below the deposit facility rate.

Money market forward rates and surveys not indicative of any further interest rate increases

At present, market participants consider the interest rate on the deposit facility, which currently stands at 4%, to have peaked. Accordingly, the ECB Survey of Monetary Analysts (SMA) conducted ahead of the October meeting shows that no further interest rate hikes are expected. The decision made by the ECB Governing Council in October was therefore in line with expectations. Money market forward rates are also not pricing in any additional interest rate steps at present and suggest that key interest rates will remain at their current levels until mid-2024. However, especially for longer maturities, money market forward rates are currently lower than they were before the October meeting of the Governing Council, as market participants are pricing in greater downside risks to the path of interest rates.

Continued reduction in APP holdings

Monetary policy asset holdings continued to decline overall during the reporting period. As before, this development is attributable to assets under the asset purchase programme (APP) that are maturing and not being reinvested. On 3 November, the Eurosystem held assets totalling €3,054.6 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). Asset holdings reported under the pandemic emergency purchase programme (PEPP) came to €1,667.6 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 also influenced by the smoothing over time of reinvestments and by the use of amortised cost accounting.[1]

Excess liquidity down again

Excess liquidity has contracted significantly since mid-August, falling by around €92 billion overall. At last count, it came to €3,552 billion. An additional final maturity and a voluntary repayment date under the third series of targeted longer-term refinancing operations (TLTRO III) contributed to this decline. Maturing assets under the APP also caused excess liquidity to shrink further. However, a decline in the liquidity-absorbing autonomous factors had an opposing effect and, taken in isolation, increased excess liquidity (see the box on pp. 26 ff.).

Monetary developments in the euro area

Annual M3 growth turns negative

The broad monetary aggregate M3 declined once again in the third quarter of 2023. As a result, its year-on-year growth rate turned negative for the first time since the start of monetary union; at the end of September, it stood at -1.2% (see the chart on p. 31). The sharp decline in monetary growth reflects the adjustment of money holdings to the changed interest rate environment. In particular, the sustained rise in interest rates motivated the money-holding sectors to shift their relatively low-interest-bearing M3 investments into higher-interest-bearing forms of investment outside of M3. As for the counterparts of money, the ongoing reduction of the Eurosystem's balance sheet alongside stagnant bank lending were a drag on M3 growth. The slowdown in lending was attributable to both demand-side and supply-side factors: demand for loans by households and non-financial corporations was dampened by the rise in financing costs and the weak economic outlook, while the banks participating in the latest round of the Bank Lending Survey (BLS) reported that they had tightened their lending policies further due to increased credit risk.

Overnight deposits reduced further in favour of short-term time deposits

The monetary aggregate M3 recorded net outflows again in the third quarter (see the table on p. 32). However, these were smaller than in the preceding quarters. This was mainly due to the fact that financial enterprises built up short-term bank deposits on balance, partially in response to a lower appetite for risk in the financial markets and a corresponding reduction in riskier assets. In addition, households barely scaled back their M3 deposits any more in net terms, but instead mainly reallocated their assets within M3. As in the previous quarters, households and non-financial corporations shifted large volumes of overnight deposits into short-term time deposits; households also continued to reduce their short-term savings deposits. The key reason for these portfolio adjustments is likely to be the slow pass-through of higher money market rates to the interest rates on overnight deposits and short-term savings deposits. This made these types of deposit relatively unattractive compared with time deposits.

Portfolio shifts into non-M3 assets

However, there were also portfolio shifts into non-M3 forms of investment. As TLTRO loans are gradually being repaid, financing via longer-term deposits and debt instruments has regained importance among banks. The yields associated with these forms of financing were also more attractive, especially in comparison with those on short-term M3 deposits. As a result, the money-holding sectors again demanded longer-term deposits and, in particular, longer-term bank debt securities on a larger scale in the third quarter, too. Data from the financial accounts suggest that households, in

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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.

particular, invested their savings, including in assets outside of the banking sector, such as government bonds. By contrast, it seems that non-financial corporations used the funds obtained from reducing their M3 deposits to a lesser extent for portfolio rebalancing. Instead, it is likely that they used the freed-up liquidity reserves to fund their increased expenditure or to pay down debt.

Increasing investment outside of M3 and rise in net external assets offset impact on M3

Alongside domestic households, non-resident investors also continued to demand euro area bonds on a larger scale during the reporting quarter. As a result, domestic non-banks recorded net inflows of funds from portfolio investment with non-residents. At the same time, the euro area current account surplus widened once again. Inflows of funds from abroad led to an increase in the MFI sector's net external assets and, taken in isolation, bolstered monetary growth. On balance, however, the dampening effects on M3 growth prevailed during the reporting quarter.

Further reduction in securitised lending to general government

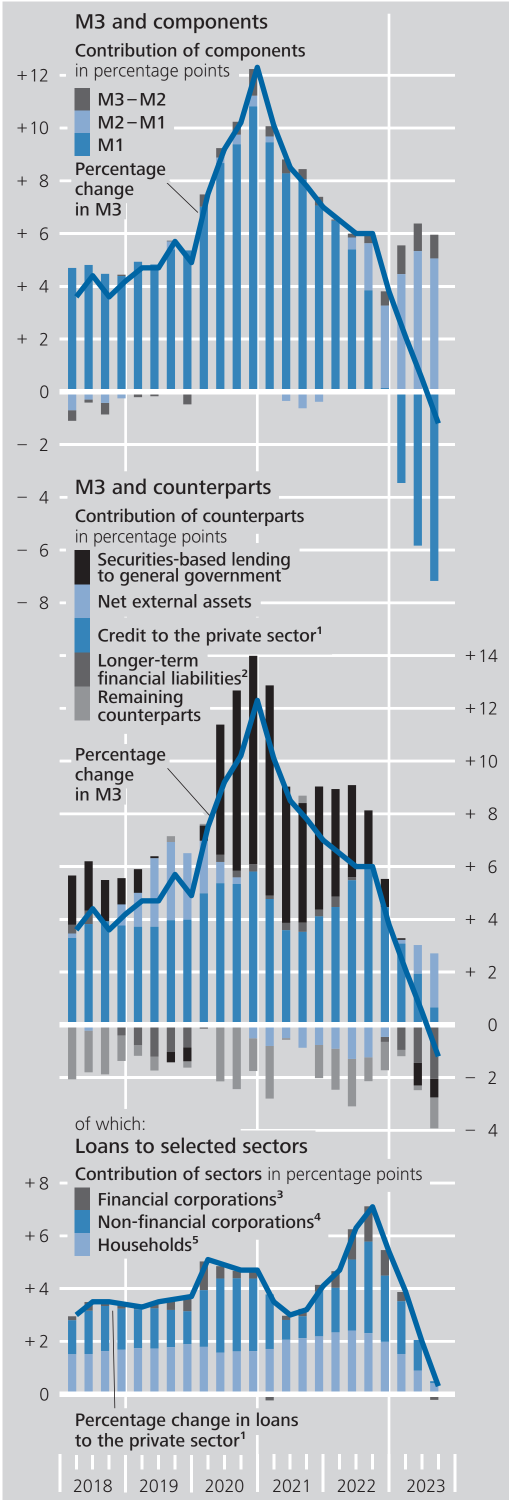
In the third quarter, the reduction in the money stock coincided with only a slight increase in lending in the euro area. While loans and securitised lending to the private sector rose slightly, credit to general government continued to decline. This was a consequence of the gradual reduction of the Eurosystem's APP portfolio, which accelerated further in July, when reinvestments under the APP were completely discontinued.

Marginal reduction in lending to non-financial corporations …

Lending to the private non-financial sector in the euro area stagnated. Loans to non-financial corporations even declined to a small degree in net terms. Among the four largest euro area Member States, only banks in France recorded net growth in this loan category, while banks in Germany, Italy and Spain posted negative balances. For the euro area as a whole, the annual growth rate for loans to enterprises fell to 0.2% by the end of September, after having been at a multi-year high of 8.9% one year ago.

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	Q2 2023	Q3 2023	Liabilities	Q2 2023	Q3 2023
Credit to private non-MFIs in the euro area	10.7	26.6	Holdings against central government[2]	– 102.1	– 25.1
Loans	– 29.6	21.7	Monetary aggregate M3	– 47.0	– 4.3
Loans, adjusted[1]	4.3	19.7	Components:		
Securities	40.3	4.9	Currency in circulation and overnight deposits (M1)	– 259.1	– 165.6
Credit to general government in the euro area	– 85.4	– 13.1	Other short-term deposits (M2-M1)	190.4	151.7
Loans	– 9.6	4.7	Marketable instruments (M3-M2)	21.7	9.7
Securities	– 75.8	– 17.8			
Net external assets	91.5	117.1	Longer-term financial liabilities	94.1	92.4
			Capital and reserves	13.5	22.2
Other counterparts of M3	– 71.9	– 67.6	Other longer-term financial liabilities	80.6	70.2

* 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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… driven by supply-side factors …

The sluggishness of loans to non-financial corporations was attributable mainly to the weak state of the economy and the changed interest rate environment in the euro area. First, the higher financing costs amongst euro area banks led them to raise their lending rates further. This dampened demand for credit. Second, banks responded to the deterioration in the risk situation among borrowers by tightening their credit standards again. Alongside the current tightening of credit standards, rounds of tightening from previous quarters are also likely to have dampened lending.

… and demand-side factors

Enterprises, too, responded to the macroeconomic environment. There was again a decline in their demand for short-term loans (see the chart on p. 33) and they were more inclined to finance their increased expenditure using their own funds rather than by taking on new loans at elevated costs. This is consistent with the fact that non-financial corporations liquidated low-interest deposits in net terms over recent quarters. At the same time, in line with their weaker investment – particularly in construction – enterprises only moderately expanded their uptake of long-term loans.

Rise in interest rates and declining financing needs related to fixed investment main reasons for sharp drop in demand, according to BLS

According to the euro area banks surveyed as part of the BLS, the third quarter of 2023 saw demand for loans to enterprises decline for the fourth time in succession. The decrease in demand for loans was equally strong for both large enterprises and small and medium-sized enterprises (SMEs). Once again, it was significantly sharper than banks had anticipated in the previous quarter. Banks are expecting a further fall in demand for loans in the fourth quarter of 2023, too. They indicated that the increase in the general level of interest rates and the decline in financing needs related to fixed investment were again the main drivers of the weak loan dynamics in the third quarter.

Further tightening of credit standards for loans to enterprises owing to greater credit risk

In the third quarter, the banks surveyed in the BLS continued to tighten their credit standards for loans to enterprises to roughly the same degree as in the quarter before. Once again, they cited elevated credit risk as the main reason for their adjustments, highlighting industry-specific and firm-specific factors above all. However, the subdued economic situation and weak economic outlook also played a part in the tightening. By contrast, BLS data suggest that bank-related factors such as risk tolerance or banks' liquidity position played a smaller role in the tightening of credit standards.

Bank lending to households was weak, as it had been in the previous quarter, registering only a slight inflow on balance. Adjusted for loan sales and securitisation, loans for house

Lending to households weak, especially with regard to loans for house purchase

purchase, which are the most important loan category in terms of volume, once again showed only a small increase. At the same time, there was a rise in net outflows in other lending (including loans to sole proprietorships). Only consumer credit continued to expand distinctly. On aggregate, the annual growth rate of loans to households fell to 0.8% at the end of September, leaving it just under 4 percentage points down on the multi-year high recorded in mid-2022.

Demand for loans to households dampened by interest rate level, inflation and house prices …

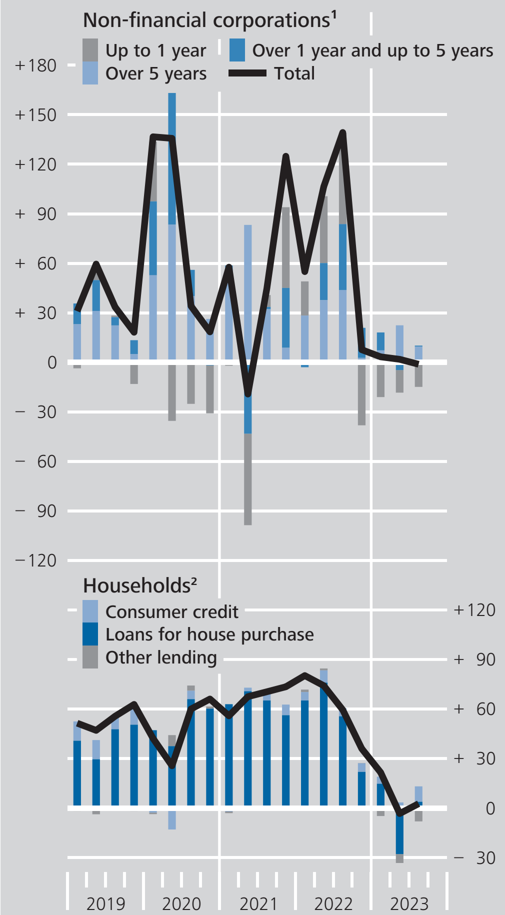
This is consistent with the fact that the banks surveyed in the BLS reported a further decline in households' demand for loans in the third quarter. Loans for house purchase in particular experienced another sharp drop in demand, the surveyed banks reported. The BLS banks estimate that demand will probably continue to decrease in the fourth quarter. The surveyed banks cited the increased general level of interest rates, the decline in consumer confidence and, in the case of housing loans, the weak housing market prospects as the main reasons for the decline in households' financing needs in the third quarter. The BLS does not ask respondents about the impact of inflation, which is also likely to have contributed to the weakening of loan growth, particularly where loans for house purchase are concerned. The high inflation rates over the past two years have reduced households' real financial assets and real disposable income. In addition, the sharp rise in construction prices and the fact that house prices are still high are weighing on demand for housing loans.

… while banks tightened their credit standards further

Banks' lending policies were another drag on loan growth. The banks surveyed in the BLS reported that they had tightened their credit standards for housing loans again and to a similar extent as in the previous quarter. This was also due to bank-related factors such as lower risk tolerance. However, as with loans to enterprises, the surveyed banks reported that they had primarily tightened their standards here based on a perceived increase in credit risk. Alongside the deterioration in the general economic situation and bleaker housing market prospects, the decline in borrowers' creditworthiness played a role here.

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

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



* Aggregates adjusted for loan sales and securitisation as well as for positions arising from notional cash pooling services provided by MFIs. **1** Non-financial corporations and quasi-corporations. **2** Including non-profit institutions serving households.

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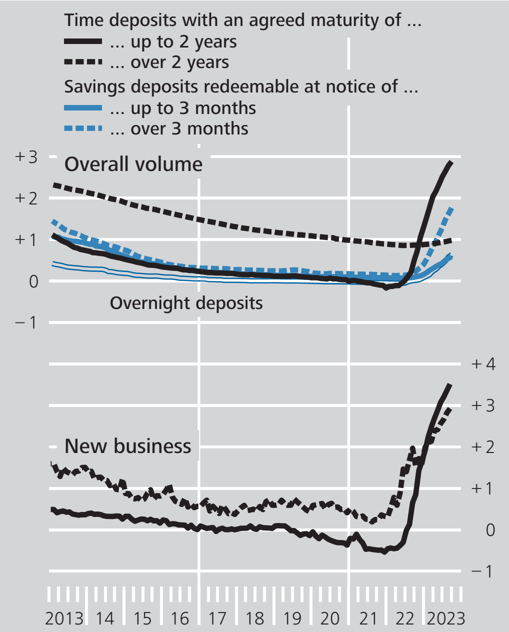
German banks' deposit and lending business with domestic customers

Only moderate growth in deposit business, with households making the largest contribution

German banks' deposit business with domestic customers grew only moderately in the third quarter of 2023. Short-term time deposits were expanded substantially again. However, their increase was largely driven by shifts from overnight deposits and short-term savings deposits

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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as investors, especially households, responded to the further increase in the yield spread between short-term time deposits remunerated at close-to-market rates and other short-term bank deposits (see the chart above). At the same time, households also built up their longer-term bank deposits given the higher remuneration on these, too.

Build-up of deposits by non-financial corporations weak again

By contrast, the build-up of deposits by non-financial corporations was comparatively small, as shown by the fact that non-financial corporations increased their short-term time deposits less strongly than in the previous quarters, whilst at the same time reducing their other short and long-term bank deposits. All in all, this development suggests a reduction in this sector's net receipts, which should be viewed in the context of high costs and weak domestic and foreign demand.

Financial corporations, meanwhile, reduced their deposits with domestic banks across all categories in the third quarter. In the current environment, the investment behaviour of this traditionally more yield-conscious sector is likely to be motivated by shifts toward higher-yield forms of investment.

Deposits by financial corporations show shifts into higher-interest forms of investment

Growth in lending business with private customers declined again

German banks' lending business with domestic private customers also continued to weaken in the third quarter of 2023. This was because banks reduced their holdings of securities issued by the private sector on balance, whilst inflows of loans remained sluggish on the back of subdued growth in lending to both households and non-financial corporations.

Lending to non-financial corporations negative, but different developments in individual maturities

Unlike in the previous quarter, banks actually recorded a slight decline in their lending business with domestic non-financial corporations in the reporting quarter. This was due to net redemptions of short and medium-term loans with maturities of up to five years. This decline was no longer primarily attributable to repayments of loans granted by the KfW Group to enterprises in the energy sector last year; instead, it was more broadly based across the categories of banks. By contrast, longer-term loans to non-financial corporations grew moderately again, with credit cooperatives and savings banks accounting for the bulk of this increase.

Higher lending rates and lower financing needs for fixed investment dampening loan demand

On aggregate, the current developments in loans to non-financial corporations reflect multiple factors and may possibly be driven by both demand-side and supply-side factors. On the one hand, the now significantly higher lending rates, subdued demand for goods and services both from within Germany and abroad, and the uncertain economic outlook are currently dampening demand for loans. BLS data substantiate this view, with survey respondents citing the higher general level of interest rates and lower financing needs related to fixed investment as the main reasons for the perceived further decline in loan demand.

Lending policies tightened further

On the other hand, lending policies also had a dampening effect on lending in the reporting quarter, with BLS banks reporting that, on balance, they had tightened their credit standards for loans to enterprises again – to the same extent as in the previous quarter – and that their credit terms and conditions were stricter overall. Just a quarter earlier, the banks had still professed unwillingness to meaningfully tighten their credit standards any further. The banks cited the increased credit risk in terms of industry-specific and firm-specific factors, the subdued economic situation and the economic outlook as the main reasons for their more restrictive lending policies.

Growth in loans for house purchase continued to weaken

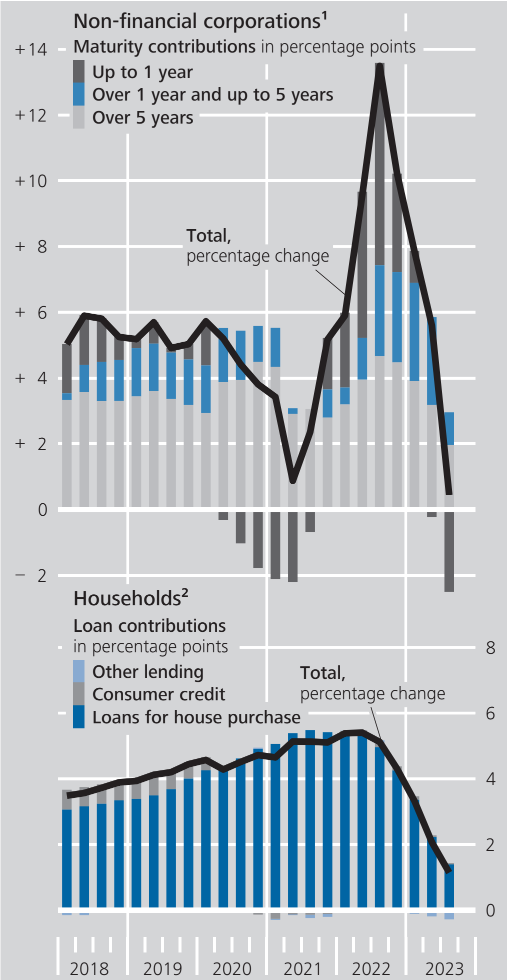
Lending to domestic households also remained weak in the third quarter, with households once again showing less demand for loans for house purchase and making noticeable repayments on their consumer credit and other borrowing overall. High inflation, elevated construction prices and further increases in financing costs dampened household demand for construction work and thus bank loans. According to the MFI interest rate statistics, the interest rates on long-term loans for house purchase continued to rise slightly on aggregate in the third quarter, reaching just under 4% at the end of the period under review.

Financing conditions for housing loans more restrictive on the whole

In addition to lending rates, banks also made their lending policies more restrictive again in the third quarter. According to the BLS, credit standards for loans to households for house purchase were tightened again on balance, albeit less sharply than in the previous quarter. Banks justified the more stringent requirements based on their perception of elevated credit risk, especially given the weak economic situation and subdued economic outlook. Credit terms and conditions were also tightened for loans to households for house purchase. This took place on a similar scale to the previous quarter, but was reflected exclusively in the widening of margins on riskier loans. Margins on average-risk loans, meanwhile, were narrowed owing to competition.

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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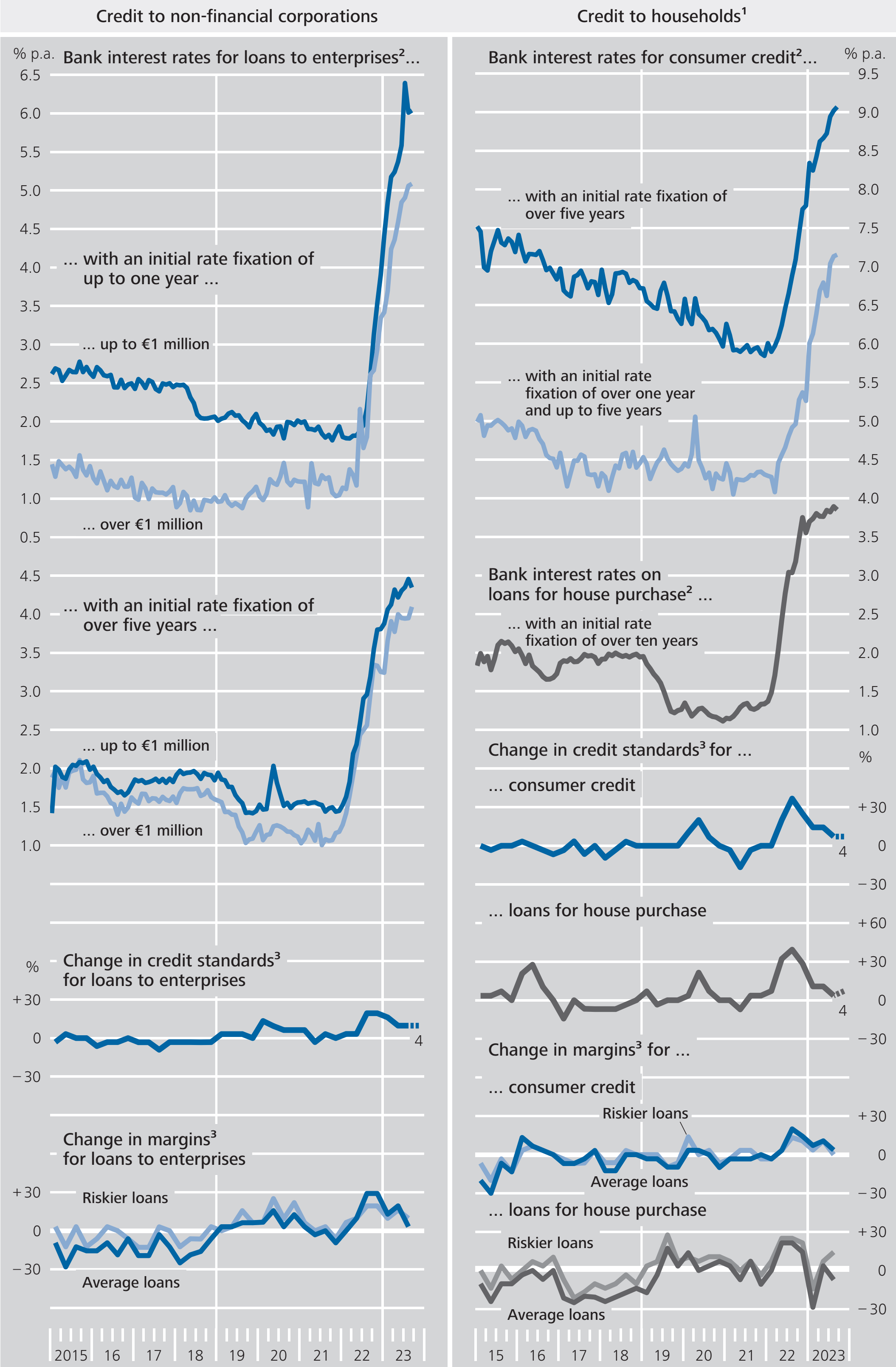
Demand for consumer credit and other lending also in decline overall

According to the BLS, credit standards for consumer credit and other lending to households were also tightened again in the third quarter of 2023. Moreover, as the financing costs for the already comparatively expensive consumer credit and other lending to households rose further, their demand for these products declined noticeably overall.

German banks' access to deposits has deteriorated

Against the backdrop of conditions in financial markets, the German banks surveyed as part of the BLS reported virtually no change in their funding situation compared with the previous quarter. Only their access to deposits deteriorated.

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 Q4 2023.

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Positive impact of Eurosystem key interest rate decisions on banks' profitability

The Eurosystem's key interest rate hikes have had, overall, a positive impact on the respondent banks' profitability over the past six months. They were a drag on non-interest income, but net interest income improved markedly. For the next six months, the banks expect the key interest rate decisions to have a far smaller impact on their profitability than in the previous six months.

Monetary policy asset portfolio impacted negatively on banks' market financing conditions

Changes in the Eurosystem's monetary policy asset portfolio have had barely any effect on the profitability of the interviewed banks over the past six months. By contrast, the impact on banks' market financing conditions and liquidity positions was negative. This probably reflects the discontinuation of reinvestments of maturing securities under the APP since July 2023.

Positive impact of TLTRO III now perceptible only in banks' liquidity position

The effects of the TLTRO III operations on banks' financial situation continued to peter out over the past six months, with banks now reporting a positive impact only on their liquidity position.

MFI* lending and deposits in Germany

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

Item	2023 Q2	2023 Q3
Deposits of domestic non-MFIs[1]		
Overnight	– 48.1	– 47.6
With an agreed maturity of		
up to 2 years	88.0	72.9
over 2 years	3.0	– 0.9
Redeemable at notice of		
up to 3 months	– 29.2	– 28.7
over 3 months	5.9	8.6
Lending		
to domestic general government		
Loans	– 0.1	3.7
Securities	– 2.3	0.3
to domestic enterprises and households		
Loans[2]	5.2	5.3
of which: to households[3]	1.4	1.1
to non-financial corporations[4]	3.7	– 1.4
Securities	2.4	– 2.0

***** 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.

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