Monetary policy and banking business

Monetary policy and money market developments

ECB Governing Council announces anticipated end of net asset purchases

In the light of further progress towards a sustained adjustment in the path of inflation to the medium-term target, the Governing Council of the ECB made a number of decisions regarding non-standard monetary policy measures and key interest rates at its meeting in June. As already announced, the purchases under the expanded asset purchase programme (APP) will continue at a monthly pace of €30 billion net until the end of September 2018. Moreover, subject to incoming data confirming the Governing Council's medium-term inflation outlook, it is now looking at reducing the net volume of monthly asset purchases to €15 billion after the end of September 2018 and discontinuing purchases entirely after the end of December 2018. The Governing Council still intends to maintain its policy of reinvesting the principal payments for an extended period of time after the end of the net purchases, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

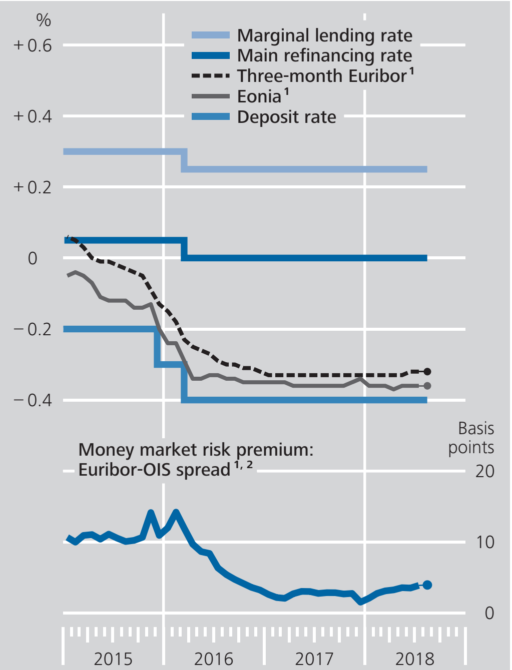
ECB Governing Council strengthens forward guidance on key interest rates

The Governing Council of the ECB kept the key interest rates unchanged in the reporting period. The main refinancing rate thus remains at 0%, while the marginal lending rate stands at 0.25% and the deposit facility rate at -0.40%. At the same time, the ECB Governing Council strengthened its forward guidance on the future development of key interest rates following its June meeting. It now anticipates that policy rates will remain at their present levels at least through the summer of 2019, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term.

Substantial progress towards sustained adjustment in inflation

The ECB Governing Council based its decision to probably terminate net asset purchases after December 2018 on the conclusion that progress towards a sustained adjustment in the path of inflation has been considerable. The Governing Council believes that the underlying strength of the euro area economy and well-anchored inflation expectations provide grounds to be confident that the convergence of inflation towards levels below, but close to, 2% in the medium term will continue in the near future as well as after the reduction and discontinuation of the net purchases. Even so, it believes that a significant degree of monetary policy accommodation is still needed to support the build-up of domestic price pressures and headline inflation developments over the medium term. The decisions taken will ensure that this monetary policy support is maintained. Following the July meeting, the Governing Council recently confirmed that, despite uncertainties related to global factors, the data avail-

Money market interest rates in the euro area



Sources: ECB and Bloomberg. **1** Monthly averages. **2** Three-month Euribor less three-month Eonia swap rate. • Average 1 to 15 August 2018.
Deutsche Bundesbank

Money market management and liquidity needs

The two reserve maintenance periods between 3 May 2018 and 31 July 2018 saw a marked increase in euro area liquidity needs stemming from autonomous factors (see the table below). Averaging €1,345.7 billion in the June-July 2018 reserve period, these needs were €70.7 billion up on their average level in the March-May 2018 reserve period. In year-on-year terms, ie compared with the June-July 2017 reserve period, this even translated into an increase of around €257 billion. Overall, the sum of the autonomous factors fluctuated within a broad corridor of between €1,233.3 billion and €1,386.7 billion in the two reserve maintenance periods under review. The above-mentioned average increase in liquidity needs of €70.7 billion arose, in particular, from the aggregate decline in net foreign assets and other factors. These autonomous factors, which are considered together because of liquidity-neutral valuation effects, contracted by €30.2 billion in net terms. Moreover, compared with the figures for the March-May 2018 period, increases in banknotes in circulation and government deposits with the Eurosystem, by €24.6 billion and €15.9 billion respectively, each helped to push up the calculated liquidity needs. Coming in at an average of €1,183.6 billion (the value of Eurosystem banknotes in circulation) and €263.4 billion (the volume of government deposits), both autonomous factors recorded sizeable stock levels in the June-July 2018 maintenance period. The minimum reserve requirement stood at €124.7 billion in the same period.

During the reporting period, market participants demonstrated a particular interest in the first voluntary early repayments of the first operation belonging to the second series of targeted longer-term refinancing operations (TLTROs II). However, the credit institutions only took limited advantage of this option. A total of no more than €11.0 billion of the previously outstanding €396.0 billion under this

Factors determining banks' liquidity*

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

Item	2018 3 May to 19 June	2018 20 June to 31 July
I Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors		
1 Banknotes in circulation (increase: –)	– 11.4	– 13.2
2 Government deposits with the Eurosystem (increase: –)	+ 29.5	– 45.4
3 Net foreign assets 1	– 1.9	+ 9.9
4 Other factors 1	– 6.9	– 31.3
Total	+ 9.3	– 80.0
II Monetary policy operations of the Eurosystem		
1 Open market operations		
(a) Main refinancing operations	– 0.1	+ 0.3
(b) Longer-term refinancing operations	– 2.2	– 13.1
(c) Other operations	+ 43.1	+ 38.5
2 Standing facilities		
(a) Marginal lending facility	+ 0.0	+ 0.0
(b) Deposit facility (increase: –)	+ 8.5	+ 7.3
Total	+ 49.3	+ 33.0
III Change in credit institutions' current accounts (I + II)	+ 58.6	– 47.0
IV Change in the minimum reserve requirement (increase: –)	+ 0.7	– 0.9

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

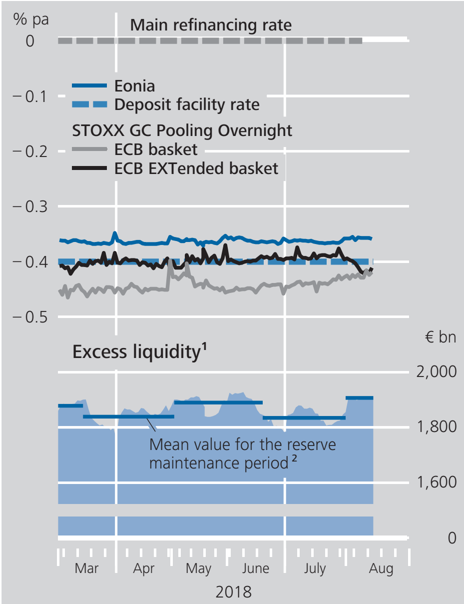
Deutsche Bundesbank

tender had been repaid at the end of June. Owing to the attractive conditions offered by the TLTROs II – depending on the lending behaviour of a given credit institution, that institution's interest rate can, in a best-case scenario, mirror the deposit facility rate of -0.40% – market players had already anticipated a modest level of repayment in advance. The total outstanding amount for all four TLTROs II now stands at around €726 billion. Furthermore, in June, banks also had the option of voluntarily repaying four TLTRO I operations prior to maturity, with actual use of this facility amounting to €3.5 billion in total. The outstanding, relatively low volumes pertaining to the eight TLTRO I operations and totalling €8.9 billion are scheduled to mature at the end of September 2018, at which time there will once again also be early repayment options for the TLTROs II. During the period under review, the outstanding tender volume was largely determined by the aforementioned repayments; in the June-July 2018 reserve period, it averaged around €746 billion, putting it just over €15 billion below the average figure for the March-May 2018 period. Of this tender volume, a relatively small proportion was again accounted for by the three-month tenders and the main refinancing operations, which recorded average volumes of €7.2 billion and €2.1 billion respectively in the June-July 2018 reserve period. This represented only a slight change compared with the March-May 2018 reserve period, in which they had posted average volumes of €7.7 billion and €1.9 billion respectively (see the chart on page 25).

The Eurosystem continued to provide the bulk of central bank liquidity through the monetary policy asset purchase programmes (see the adjacent table), which accounted for just over three-quarters of the liquidity provided via the open market operations, according to the average figures for the June-July 2018 reserve period. The average balance sheet holdings of all purchase programmes in this period stood at €2,558 billion, €82 billion above the corresponding average holdings recorded for the May-March 2018 reserve period.

Central bank interest rates, money market rates and excess liquidity

Daily data



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

Eurosystem purchase programmes

€ billion

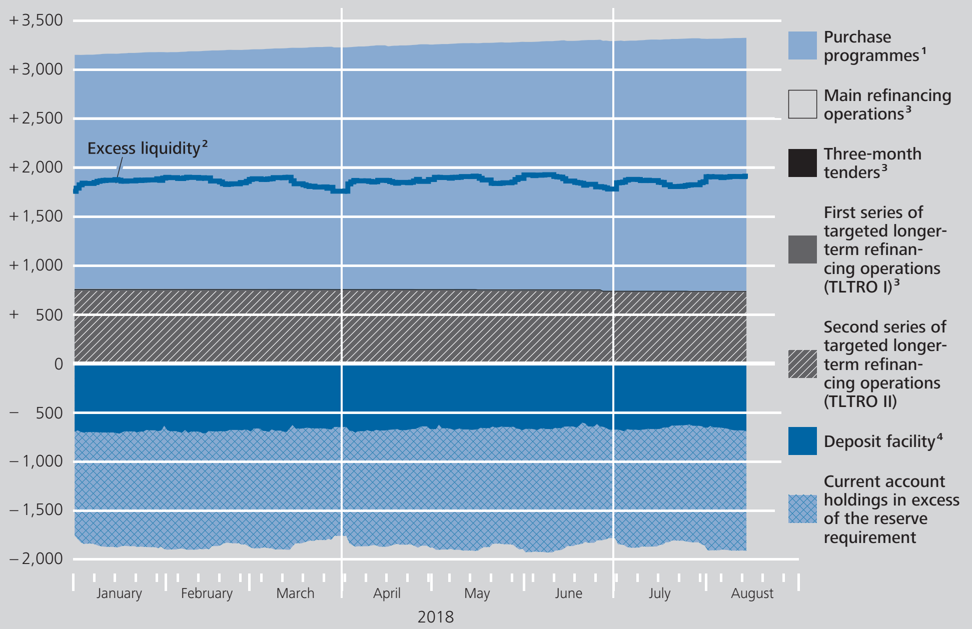
Programme	Change across the two reserve periods	Balance sheet holdings as at 10 August 2018
Active programmes		
PSPP	+ 66.5	2,046.1
CBPP3	+ 3.6	256.7
CSPP	+ 12.8	165.7
ABSPP	+ 0.7	27.8
Completed programmes		
SMP	− 6.2	74.3
CBPP1	− 0.7	4.5
CBPP2	− 0.3	4.0

Deutsche Bundesbank

Despite this injection of liquidity, the level of excess liquidity declined slightly on balance in the period under review. At an average volume of €1,834 billion in the June-July 2018 reserve period, it was just under €5 billion below its level in the March-May 2018 period, notwithstanding a slight hike in the May-June 2018 average for a time to a figure of €1,851 billion. This represented a continuation of the trend evident since the end of last year that saw excess liquidity cease to grow by any sig-

Liquidity provision and use

€ billion, daily data



Sources: ECB and Bundesbank calculations. **1** Securities markets programme (SMP), covered bond purchase programmes (CBPP1, CBPP2 and CBPP3), asset-backed securities purchase programme (ABSPP), public sector purchase programme (PSPP) and corporate sector purchase programme (CSPP). **2** Current account holdings minus the minimum reserve requirement plus the deposit facility. **3** Volume so small it is hardly visible. **4** The marginal lending facility is not shown in this chart owing to its very low volume.

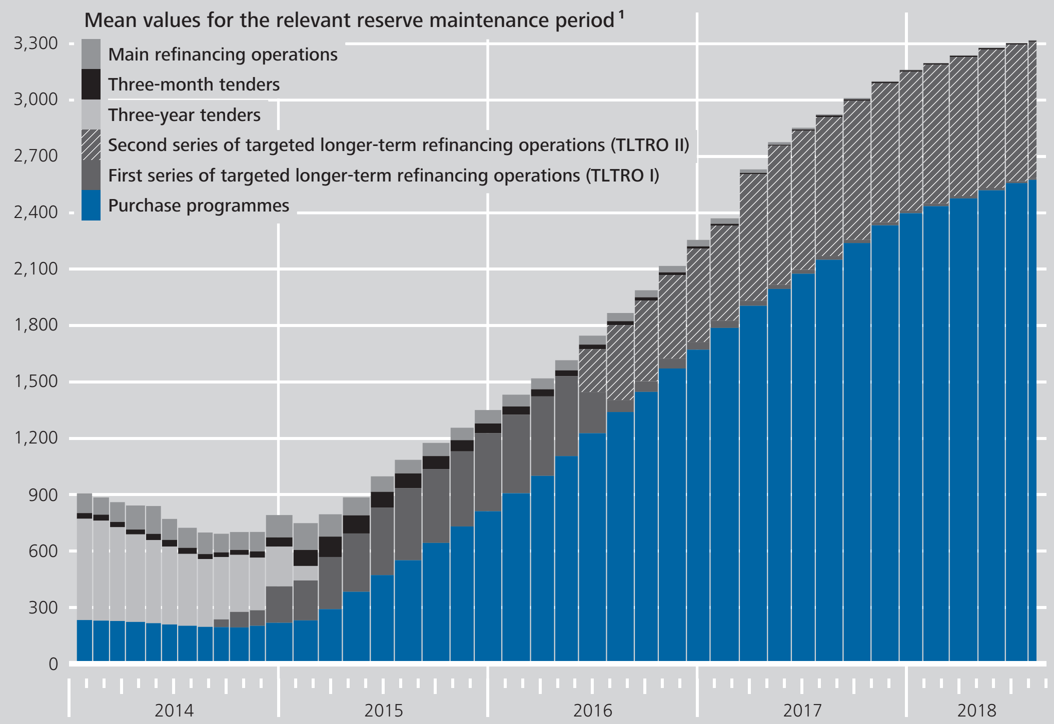
Deutsche Bundesbank

nificant margin, or even shrink, primarily because of greater liquidity needs stemming from autonomous factors (see the above chart).

Thanks to the ongoing prevalence of extremely comfortable liquidity conditions, overnight rates continued to be geared towards the deposit facility rate (see the chart on page 23). In the May-June 2018 and June-July 2018 reserve periods, Eonia averaged -0.36% and thus remained above the deposit facility rate. Throughout the period under review, Eonia fluctuated between -0.37% and -0.35%. The Eonia volumes reported for unsecured overnight money once again contracted, generating an average daily turnover of €4.6 billion in the June-July 2018 reserve period and €3.2 billion in the previous period. The volume concerned had averaged €5.6 billion in the March-May 2018 reserve period. Meanwhile, in the period under review, secured overnight money in GC Pooling traded at an average of -0.44% in the ECB basket. This resulted in an average rate that was one basis point above the previous review period and that continued to trade below the deposit facility rate. Overnight money in the ECB EXTended basket, with its larger set of eligible securities, traded at -0.40% on average in the May-June 2018 reserve period and at -0.39% in the June-July 2018 reserve period. Compared with previous periods and the same period of the preceding year, at an average of €7.1 billion, the underlying GC Pooling Overnight turnover in the two baskets was up in overall terms. In this context, at an average level of €7.6 billion, turnover in the June-July 2018 reserve period was once again higher than in the previous period, when it had averaged €6.6 billion. The trading volume had stood at an average level of €5.9 billion in the March-May 2018 reserve period. The end of the half-year period at the close of June 2018 again had an impact on overnight rates and their associated turnover. While Eonia was found to be up on the day by one basis point, secured overnight money in the EXT basket was trading two basis points lower at a rate of -0.46%. Reduced turnover was observed for unsecured and secured overnight money alike.

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

€ billion



Sources: ECB and Bundesbank calculations. **1** The bar width corresponds to the length of the reserve maintenance period. The last period displayed is still ongoing.
Deutsche Bundesbank

able in the meantime still point to solid and broad-based economic growth in the euro area.

Purchase volumes still in line with announced target

On 10 August, the Eurosystem's asset holdings under the APP came to €2,496.3 billion. At €2,046.1 billion, the largest share of this by far was attributable to securities holdings under the public sector purchase programme (PSPP). At last count, the average residual maturity of the PSPP portfolio remained unchanged at 7.6 years. The outstanding amounts acquired to date under the third covered bond purchase programme (CBPP3) and the asset-backed securities purchase programme (ABSPP) came to €256.7 billion and €27.8 billion respectively. Holdings under the corporate sector purchase programme (CSPP) totalled €165.7 billion as at 10 August.

41 banks repay €11 billion from the first TLTRO II operation

On 27 June, credit institutions had their first chance to use the voluntary repayment option for the first operation of the second series of targeted longer-term refinancing operations (TLTROs II). A total of 41 institutions paid back loans totalling around €11 billion to the Eurosystem, which was only a relatively small proportion of the outstanding tender volume of just under €400 billion. The attractive interest rates that apply to the entire maturity of the TLTRO II are probably one of the major reasons why early repayments were not higher.

Excess liquidity shows slight decline

Excess liquidity fell slightly in the period under review, declining by a total of €4 billion to €1,909 billion. From as early as the end of last year, the volume of excess liquidity has no longer risen significantly, but has instead moved within a certain range depending on fluctuations in the autonomous factors. Here, trend growth in the autonomous factors is partially offsetting the additional liquidity provided by means of the monthly net purchases under the APP, which have been reduced to €30 billion since January 2018.

Money market interest rates virtually unchanged overall

During the period under review, the unsecured overnight money market rate (Eonia) continued to move within a narrow range of between -0.35% and -0.37%, and the secured overnight rate (STOXX GC Pooling) remained in a range below the deposit rate of -0.40%. The three-month Euribor went up marginally in the reporting period, standing at -0.32% at last report.

Shift in expected date of first key interest rate hike

In the first few days after the ECB Governing Council's June meeting, the money market forward rates derived from the Eonia swap curve went down markedly. At present, an increase in the deposit facility rate – depending on the assumed size of the first interest rate hike – is not factored into forward rates until the period from the fourth quarter of 2019 to the second quarter of 2020, which is much later than anticipated before the June meeting.[1] This delay of more than one quarter should probably partly be interpreted as a market response to the stronger forward guidance on key interest rates. However, money market rates are not solely a reflection of interest rate expectations, but also include term premiums, which may change in response to incoming economic data.[2] Survey-based measures, which exclusively capture interest rate expectations, also showed a postponement of interest rate hike expectations following the June meeting; however, they point to September 2019 as the date for the first key interest rate hike, which is sooner than the dates derived from the money market forward rates. If money market forward rates are adjusted for term premiums, which are currently estimated to be negative,[3] the interest rate path derived from this is closer to the survey results and thus also closer to the date-based element of the stronger forward guidance, which suggests that key interest rates will remain unchanged "at least through the summer of 2019".

Monetary developments in the euro area

Credit growth still reflected in monetary dynamics

Following two significantly weaker quarters, growth in the broad monetary aggregate M3 in the spring months returned closer to the robust developments of the previous year. The reduction in the monthly volume of asset purchases by the Eurosystem under the APP since the beginning of the year has therefore not led to a sustained downward trend in monetary growth as yet. This was mainly due to a pick-up in lending to the private sector. With economic growth continuing to be sound, both loans to non-financial corporations and loans to households again posted significant inflows. The increasingly lively demand for credit in the euro area was also bolstered by the interest rate environment. Furthermore, the results of the latest Bank Lending Survey (BLS) indicate that euro area banks continued to ease their credit standards in all loan segments in the second quarter.

Increase in overnight deposits dominant factor in M3 growth

Monetary growth during the reporting period was again dominated by the increase in overnight deposits, which rose again significantly after two weaker quarters. Furthermore, the increase in other short-term deposits was also relatively robust. Looking at the sectors, households, in particular, stepped up their use of savings deposits as well as overnight deposits,

1 Plausible estimates as to how large the first interest rate hike might be can be derived from surveys on interest rate expectations and range from 10 to 25 basis points.
2 The term premiums for money market forward rates are currently negative according to model estimates. This can be explained by the fact that market participants are willing to accept a yield discount in order to hedge against (adverse) scenarios in which interest rates remain low for longer than expected.
3 This type of adjustment is carried out using a term structure model, which breaks down the path followed by money market forward rates into the path followed by the exclusive interest rate expectations and the risk premiums. It shows that, at present, the most likely interest rate path generated by the model, adjusted for risk premiums, is closer to the survey results. For more detailed information on the extraction of interest rate expectations at the lower bound, see F Geiger and G Schupp, With a little help from my friends: Survey-based derivation of euro area short rate expectations at the effective lower bound, Deutsche Bundesbank Discussion Paper No 27/2018.

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

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

Assets	2018 Q2	2018 Q1	Liabilities	2018 Q2	2018 Q1
Credit to private non-MFIs in the euro area	85.2	115.6	Holdings against central government[2]	– 21.4	– 16.5
Loans	52.7	102.4	Monetary aggregate M3	175.4	82.5
Loans, adjusted[1]	104.3	97.2	*of which* Components		
Securities	32.6	13.2	Currency in circulation and overnight deposits (M1)	165.2	105.2
Credit to general government in the euro area	34.7	– 39.6	Other short-term deposits (M2-M1)	19.2	– 15.2
Loans	– 3.8	– 10.6	Marketable instruments (M3-M2)	– 9.1	– 7.5
Securities	38.1	– 28.9	Longer-term financial liabilities	– 45.6	11.4
			of which		
Net external assets	– 75.8	61.6	Capital and reserves	– 11.3	16.3
Other counterparts of M3	64.6	– 60.3	Other longer-term financial liabilities	– 34.3	– 4.9

* Adjusted for statistical changes and revaluations. **1** Adjusted for loan sales and securitisation as well as for positions arising from notional cash pooling services provided by MFIs. **2** Including central government deposits with the MFI sector and securities issued by the MFI sector held by central governments.
Deutsche Bundesbank

thus continuing the trend, observed for some time now, of risk-averse investors' preference for deposits with the shortest possible maturities in the face of persistently low interest rate spreads between deposit types. By contrast, non-monetary financial corporations increasingly accumulated short-term time deposits in the quarter under review. However, the extent to which they did so varied widely between the different euro area countries (for more information on developments in Germany, see also pages 30 to 31). On balance, the annual growth rate of M3 at the end of the quarter rose to 4.4%, thus edging back up towards the 5% mark around which it had hovered in 2016 and 2017.

Loans to non-financial corporations main driver of credit growth, …

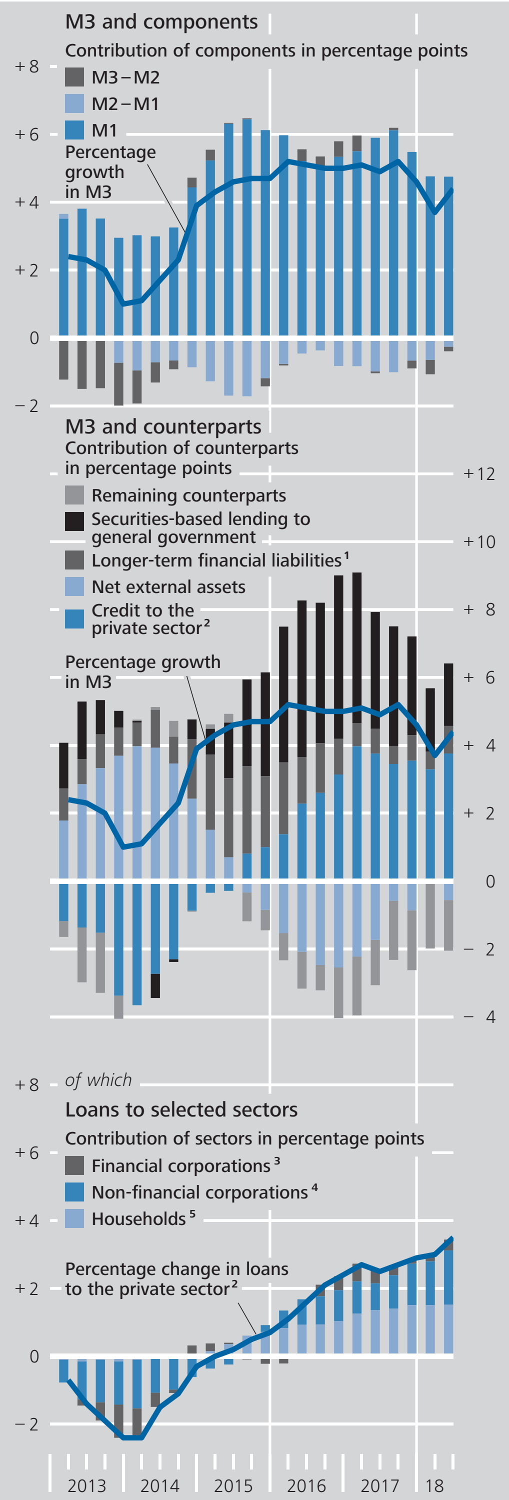
Of the counterparts, lending by the MFI sector to the private non-MFI sector in the euro area was again the main driver of monetary growth in the second quarter of 2018. The corresponding contribution to M3 growth compared to the previous year increased from 2.8 to 3.3 percentage points, primarily off the back of more dynamic lending to non-financial corporations. Adjusted for securitisations and other one-off effects, its annual growth rate rose to 4.1% in the second quarter, putting it around 2 percentage points higher than a year earlier.[4] The significant growth in demand for loans was driven by the favourable financing conditions, as well as the continued economic upturn involving, in particular, a substantial increase in investment in machinery and equipment in many euro area countries. In a cross-country comparison, the main growth stimuli for loans to non-financial corporations continued to emanate from Germany and France. However, in the last few quarters, lending in a number of smaller core countries, as well as in Italy and Spain – albeit to a smaller degree – also contributed to the euro area aggregate (see the chart on page 29).

This is consistent with the banks surveyed as part of the BLS reporting a marked increase in the demand for loans by non-financial corporations in the euro area as a whole in the second quarter. The dynamic developments reported in the recent survey rounds thus continued. Besides citing the low general level of interest rates as the main factor, bank managers also attributed the increase in demand to, amongst other things, a rise in financing needs for inventories and working capital, fixed investment

4 In the second quarter of 2017, a one-off special effect in June dragged down the annual growth rate of loans to non-financial corporations in the euro area, but did not have a lasting effect on loan developments (see also Monetary developments in the euro area: June 2017, ECB press release dated 27 July 2017). The corresponding annual growth rates in the first and the third quarters of 2017 were 2.4% and 2.5% respectively.

Monetary aggregates and counterparts in the euro area

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



Source: ECB. **1** Denoted with a negative sign because, per se, an increase curbs M3 growth. **2** Adjusted for loan sales and securitisation as well as for positions arising from notional cash pooling services provided by MFIs. **3** Non-monetary financial corporations and quasi-corporations. **4** Non-financial corporations and quasi-corporations. **5** Including non-profit institutions serving households.

Deutsche Bundesbank

as well as for mergers, acquisitions and restructuring. By contrast, enterprises' use of internal financing as well as lending by non-banks had a dampening effect on demand when taken in isolation, as in earlier surveys.

… also supported by further easing of banks' lending policies

Given what remains a very expansionary monetary policy and fierce competition between banks, financing conditions were still extremely favourable. On the one hand, interest rates for loans to enterprises throughout the euro area were once again close to historical lows in the reporting quarter. On the other, the banks surveyed as part of the BLS reported a further easing of credit standards. They stated that, on balance, they had continued to ease their credit standards and credit terms and conditions for loans to enterprises at the euro area aggregate level in the reporting quarter.

Continued growth in loans to households again driven by loans for house purchase, …

In the quarter under review, loans to households in the euro area likewise experienced distinct growth. Banks from Germany, France and Italy were the main contributors to the fairly stable year-on-year growth of just under 3% over the last few quarters. Loans for house purchase were once again the driving force of growth, increasing slightly more markedly than in the previous quarter. This is consistent with the fact that the banks surveyed in the BLS reported a significant increase in demand for housing loans. According to the bank managers, the rise in the need for funds was mainly due to the low general interest rate level, but also to households' continued upbeat assessment of housing market prospects and stable consumer confidence. Institutions reported minor dampening effects on demand, mainly resulting from the internal financing of house purchases out of savings, as well as from lending by competitor institutions.

… likewise supported by expansionary credit standards, …

Banks' lending policies remained expansionary in this loan segment as well. On balance, credit standards in this segment were eased moderately in the reporting quarter. In addition, the surveyed banks were more accommodating with their credit terms and conditions and further reduced the margins for average-risk loans, in particular. According to what the surveyed institutions reported, this essentially occurred – as in the previous quarters – against the backdrop of the high level of competition in the banking and non-banking sectors and a better assessment of the risks associated with loans extended by credit institutions.

… but also by continued strong growth in consumer credit

Consumer credit growth stayed strong in the reporting quarter and, at an annual growth rate of 7.0% at the end of June, remained the fastest growing component of loans to households. In bank-supply-side terms, this was supported by the fact that the banks surveyed in the BLS on balance again marginally eased their credit standards in this loan segment as well. According to the surveyed euro area banks, the demand for consumer credit and other loans gained even more momentum compared with the last six quarters. Respondents put the higher demand down to robust consumer confidence, the low general level of interest rates, and the high propensity to purchase. The latter was further bolstered in the reporting quarter by the sound economic growth and the steady improvement in the labour market.

Expansion of securities-based lending, in particular by the Eurosystem, represents an additional pillar of M3 growth

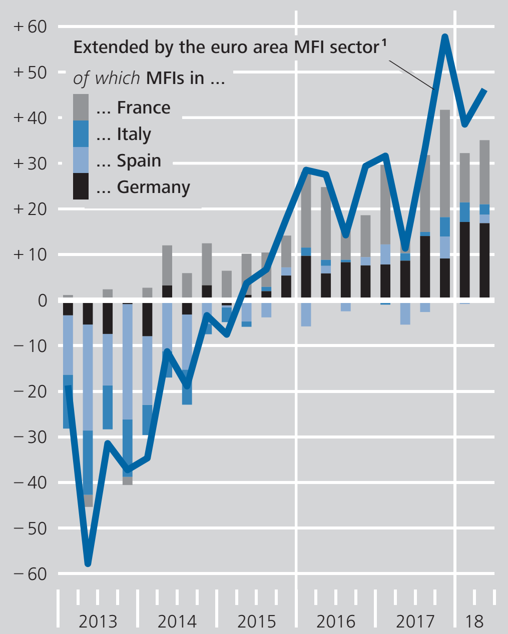
Besides loans, securities-based lending to general government and private enterprises in the euro area represented a key pillar of M3 growth in the reporting quarter (see adjacent chart). Growth was again driven by the Eurosystem's monthly net asset purchases under the APP. Given the renewed scale-back of these monetary policy purchases in January 2018, however, growth in the first half of 2018 was markedly weaker than in the period from 2015 to 2017. Another factor behind the increase in securities-based lending was that the commercial banking sector on balance substantially expanded its stock of debt securities issued by the private sector in the reporting quarter.

Another positive contribution to monetary growth came from the decline in other liabilities of the MFI sector. Monetary capital, in particular, again recorded significant net outflows in the reporting quarter. Given the low interest rate advantage, the attractiveness of longer-term deposits and debt securities is probably still limited from the point of view of non-banks.

Monetary capital outflows support expansion of the money stock

Loans to non-financial corporations in the euro area*

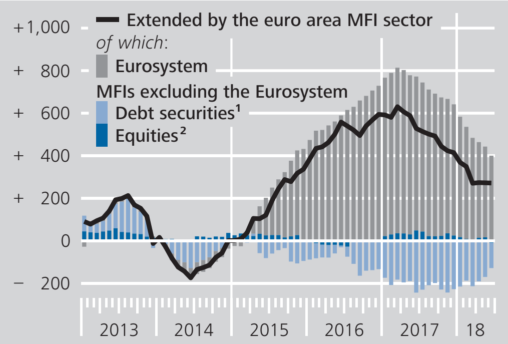
€ billion, 3-month accumulated flows, end-of-quarter data, seasonally adjusted



Sources: ECB and Bundesbank calculation. * Loans to non-financial corporations and quasi-corporations, adjusted for loan sales and securitisation. 1 Also adjusted for positions arising from notional cash pooling services provided by MFIs.
Deutsche Bundesbank

Securities-based lending* to non-banks in the euro area

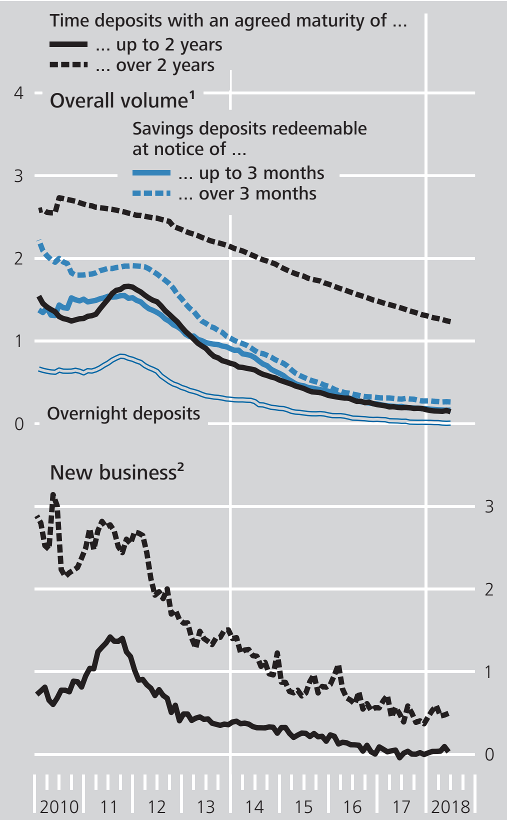
€ billion, 12-month accumulated flows



Sources: ECB and Bundesbank calculations. * Eurosystem: debt securities only; MFIs excluding the Eurosystem: debt securities and equities. 1 Including money market instruments. 2 Including shares in investment funds (other than money market funds).
Deutsche Bundesbank

Interest rates on bank deposits in Germany*

% pa, monthly data



* Deposits of households and non-financial corporations. **1** According to the harmonised MFI interest rate statistics. Volume-weighted interest rates across sectors. Interest rate levels for overnight and savings deposits may also be interpreted as new business due to potential daily changes in interest rates. **2** According to the harmonised MFI interest rate statistics. Volume-weighted interest rates across sectors and maturities. Unlike the overall volume of contracts (ie deposit contracts on the balance sheet at the end of the month), the volume of new business (ie all contracts concluded in the course of a month) is explicitly recorded for time deposits only.

Deutsche Bundesbank

Net external asset position has a per se dampening effect on monetary growth

By contrast, the MFI sector's net external asset position curbed monetary growth in the quarter under review. This counterpart consequently experienced a degree of volatility comparable to that of recent quarters. According to the balance of payments data for April and May available thus far, the outflow of funds was attributable to the current account surplus of the euro area being more than offset by a higher negative financial account balance. Non-resident investors sold euro area assets on balance in April and May, whereas domestic non-banks continued to purchase foreign securities. Amongst other things, these capital flows are likely to be linked to the temporarily heightened political uncertainty in parts of the euro area, as well as to the statements by the Governing Council of the ECB on the future development of key interest rates, which were perceived as being accommodative.

German banks' deposit and lending business with domestic customers

Deposit growth still dominated by build-up of overnight deposits

German banks' deposit business with domestic customers remained positive in the second quarter and was even more buoyant than in previous quarters. Short-term types of deposit remained popular among investors. Thus, overnight deposits once again recorded significant growth between April and June. At the same time, unlike in the previous quarters, short-term time deposits remunerated at close-to-market rates also expanded markedly once more. The persistently high preference of the money-holding sectors for short-term bank deposits still needs to be seen in conjunction with the historically low yield premium on longer-term bank deposits (see adjacent chart).

Largest contribution once again from private non-financial sector

Households again contributed the bulk of the increase in overnight deposits. Non-financial corporations, too, again perceptibly scaled up their overnight deposits in the reporting quarter, even though remuneration on these deposits has been in negative territory for several quarters and fell slightly again of late. Besides the interest rate constellation, the persistently high levels of interest shown by these sectors in highly liquid bank deposits is likely to have been boosted by the declining yields on riskier forms of investment in recent quarters (see the box on pages 32-34).

Investment behaviour within the financial corporate sector remains very heterogeneous

Moreover, the financial corporations sector, which traditionally has a greater interest in seeking higher returns, saw an increase in bank deposits during the period under review. However, the investment behaviour of individual financial agents remained very heterogeneous in the quarter under review as well. While insurers and pension funds continued to reduce their long-term bank deposits during the reporting period – a process observed since mid-2009 – other financial corporations built up their short-term time deposits significantly. This development was likely due, in part, to the expectation of rising interest rates and the associated interest rate uncertainty, which, taken in isolation, favoured the temporary parking of funds in the form of liquid bank deposits.

Lending business with domestic non-banks expanded further, driven by the private sector

Banks' lending business with the domestic non-bank sector was exceptionally dynamic in the reporting quarter. This was mainly due to loans to the domestic private sector growing strongly as well as to the fact that banks once again distinctly increased their holdings of securities issued by the private sector. In contrast to the previous year, banks purchased fewer equity and investment fund shares; instead, they increasingly acquired debt securities. This development was once again counterbalanced by lending to the public sector. In view of the very favourable budgetary situation, loans to this sector declined for the eleventh consecutive quarter. In addition, banks (again) reduced their net holdings of government bonds.

Non-financial corporations show greater interest in bank loans

The largest net inflows in loans to the private sector in the quarter under review were recorded for loans to non-financial corporations. In line with the positive impetus from private consumption and rising levels of fixed investment, domestic enterprises again showed strong interest in bank loans; this meant that the increase in demand for this form of financing observed since the beginning of 2017 continued. The annual growth rate for loans came to 5.9% at the end of the quarter under review – a level higher in this credit segment than at any time since the end of 2008.

The latest expansion occurred across all maturities, most notably for loans with a maturity of more than one year. This development suggests that German enterprises continued more strongly to finance their short-term expenditure with their own funds. At the same time, enterprises' demand for loans with longer maturities is likely to have been supported by the desire to lock in interest rates. Although interest rates for longer-term loans to enterprises have remained at a very low level, there has been a slight trend increase in the past few months (see the chart on page 36).

Lending and deposits of monetary financial institutions in Germany*

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

Item	2018 Q1	2018 Q2
Deposits of domestic non-MFIs[1]		
Overnight	34.1	36.7
With an agreed maturity of		
up to 2 years	− 0.5	6.0
over 2 years	− 4.7	− 1.0
Redeemable at notice of		
up to 3 months	0.3	1.2
over 3 months	− 1.6	− 1.0
Lending		
to domestic general government		
Loans	− 10.3	− 4.7
Securities	− 8.9	− 6.9
to domestic enterprises and households		
Loans[2]	31.9	33.6
of which to households[3]	17.2	14.7
to non-financial corporations[4]	12.3	16.7
Securities	− 5.9	5.2

* 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

Lending policies eased for loans to enterprises

The latest BLS results provide additional information on the underlying demand factors in Germany. According to the bank managers, the increase in demand was fuelled not only by the low general level of interest rates but, above all, by higher financing needs for fixed invest-

Developments in the real portfolio returns of households in Germany

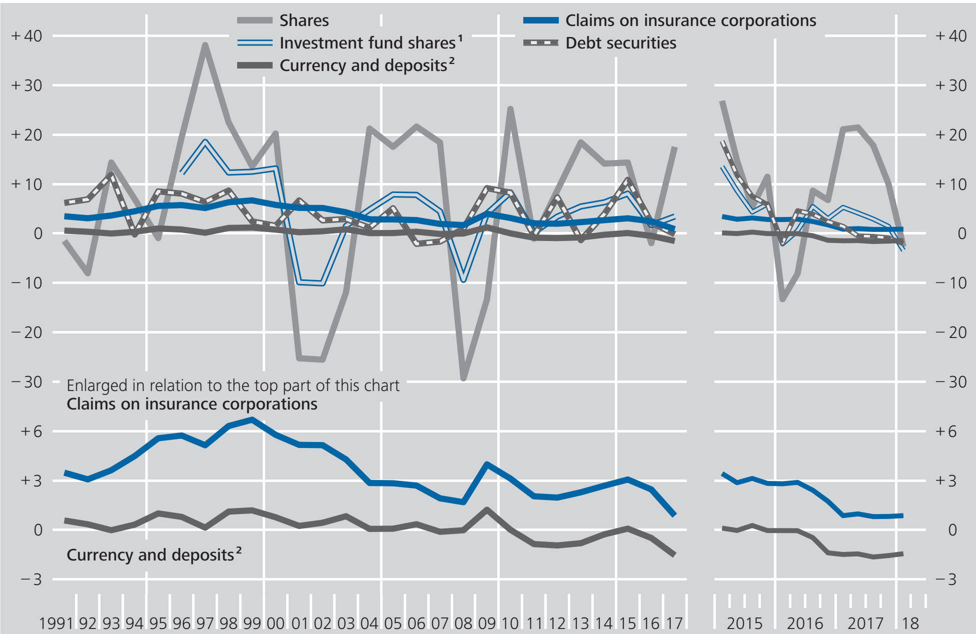
Interest rates on bank deposits in Germany remain at a historically low level. Taken in isolation, this is depressing the return accruing to households from their financial asset holdings. That being said, aside from bank deposits, German households also have holdings in the form of securities and claims on insurance corporations, and the returns on these therefore also need to be taken into account. For instance, developments in the total return on financial assets in this sector are influenced not just by deposit rates but also, and in particular, by returns on claims on insurance corporations as well as price effects and dividend payouts on securities. This box details the path of returns on various types of financial asset and the total return up to the current end as defined by the available data (the first quarter of 2018), thus carrying on from past calculations.[1] In this context, there is merit in viewing generated returns in real terms, as the purchasing power of nominal returns fluctuates in line with inflation.[2]

The chart below shows the evolution of real returns on the main types of financial asset in the portfolio of households in Germany between 1991 and the first quarter of 2018.

1 For details, see Deutsche Bundesbank, Investment behaviour in the low-interest-rate environment, Annual Report 2017, pp 16-18; Deutsche Bundesbank, Real portfolio returns of households in Germany, Monthly Report, August 2017, pp 31-33; and Deutsche Bundesbank, German households' saving and investment behaviour in light of the low-interest-rate environment, Monthly Report, October 2015, pp 13-31.
2 In addition, it is also possible to view this after tax, leading to qualitatively similar results. However, compensation for inflation, being a component of nominal interest, has customarily been taxed more heavily, particularly in the past. See also Deutsche Bundesbank, Return on private financial assets taking into account inflation and taxes, Monthly Report, July 2017, pp 69-75.

Real returns on various types of financial asset held by households in Germany

% pa, annually / quarterly

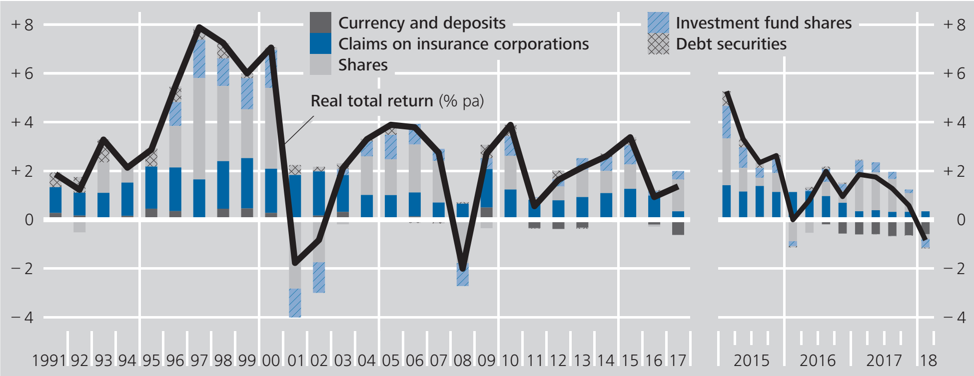


Sources: Assekurata, German Insurance Association (Gesamtverband der Deutschen Versicherungswirtschaft) and Bundesbank calculations. **1** Data on the annual return on investment fund shares are only available as from 1995 Q4. **2** Nominal deposit interest rates are based on the Bundesbank's interest rate statistics until 2002 and on the harmonised MFI interst rate statistics as from 2003. The period prior to 2003 and the years from 2003 onwards can therefore only be compared to a limited degree.

Deutsche Bundesbank

Contribution of individual types of financial asset* to the real total return of households in Germany

Percentage points, annually/quarterly



* Weighted according to share of total financial assets.
Deutsche Bundesbank

For much of that time, bank deposits (including currency) which, at just under 40%, consistently constituted the bulk of the portfolio, yielded the lowest real returns; these slipped into clearly negative territory, most notably since the middle of 2016. Moreover, since the beginning of 2017, the real return on insurance claims dipped to a particularly low level, with returns on securities, which tend to be comparatively volatile, likewise heading downward of late. This was initially driven by dwindling price gains in the capital market compounded by heavy losses, primarily in the first quarter of 2018.

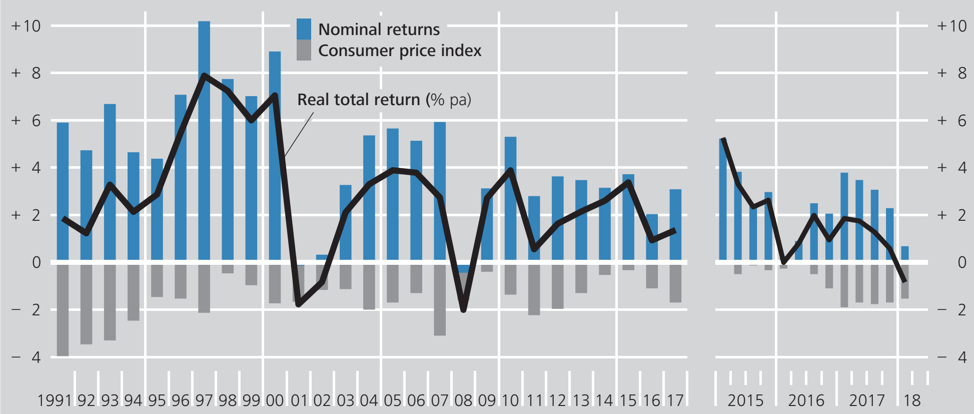
Weighting the returns on the various types of financial asset with their respective time-varying portfolio share reveals the real total return accruing to households in Germany as a whole (see the above chart). This total return rose to an average size of 1.4% in 2017, having stood at 0.9% in 2016. In line with the path followed by returns on securities, however, it fell over the course of last year to stand at -0.8% at the beginning of 2018, thereby entering into negative territory for the first time in six years.

In particular, the total return was dampened by returns on bank deposits, whose contribution to the total return since the end of 2016 has entered further into negative territory than ever before in the reporting period. Returns on securities also reduced the total return significantly in the first quarter of 2018. The only positive contribution at the current end, as well as throughout the reporting period, stemmed from claims on insurance corporations; however, that contribution has been minor since 2017.

It is possible to calculate not just the role played by individual types of asset in connection with the real total return, but also the contribution of nominal returns, on the one hand, and the rate of inflation (as measured by the consumer price index, CPI), on the other (see the upper chart on page 34). Generally speaking, nominal returns had the largest, and a broadly positive, impact on the real total return over the entire reporting period. However, this contribution waned considerably in the course of 2017, primarily as a result of price losses in the capital market. Given that inflation at the same time remained relatively stable at positive levels of between 1.5% and 2%, the real total return *per se* was reduced by a significant margin. Lastly, in the first quarter of 2018, the negative contribution arising from the inflation rate exceeded the positive contribution generated by nominal returns, causing the real total return to fall below zero at the current end.

Contributions to the real total return of households in Germany

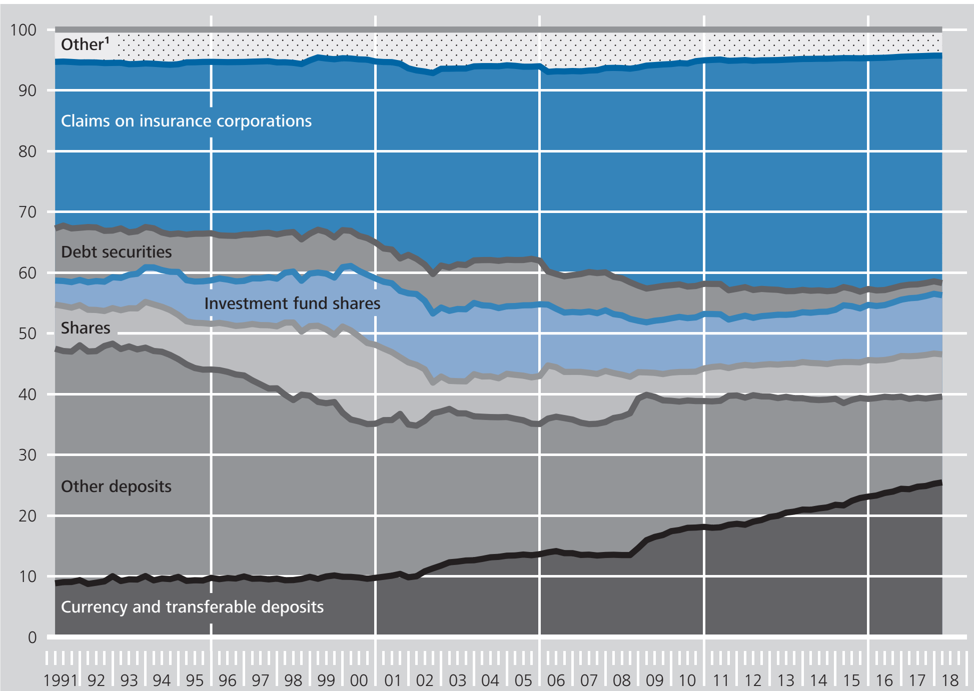
Percentage points, annually/quarterly



Deutsche Bundesbank

Structure of German households' financial assets

%, end-of-quarter data



1 Besides other accounts receivable, this also comprises other equity.
Deutsche Bundesbank

For the most part, changes in portfolio composition only affected the evolution of the total return in a minor way (see also the lower chart on this page). Such changes may be triggered by active portfolio shifts or, particularly in the case of securities, by valuation effects. Their negligible importance is consistent with the observation that, despite the persistent low-interest-rate environment, no major portfolio shifts were carried out by households.[3]

3 With regard to possible portfolio shifts within the money-holding sectors in Germany, see Deutsche Bundesbank, Acquisition of financial assets and the search for yield in Germany, Monthly Report, May 2018, pp 30-33.

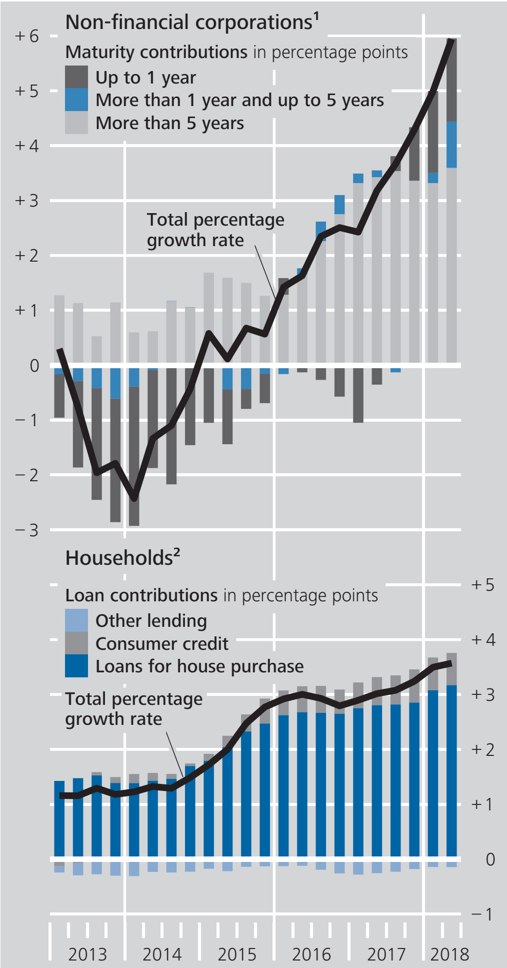
ment as well as for mergers, acquisitions and restructuring, while enterprises' recourse to their ample internal financing resources continued to curb demand. Furthermore, the latest results of the BLS indicate that banks eased their credit standards as well as credit terms and conditions for loans to enterprises in the second quarter of 2018, with the effect that demand is likely to have been further stimulated by banks' supply behaviour.

Persistently high household demand for loans for house purchase; positive momentum in consumer credit persists

The second key pillar of German banks' lending business remained loans to households. Crucial for the most recent spell of growth were once again loans for house purchase, which were similarly buoyant during the reporting period as in the previous quarters. On balance, the growth rate of loans for house purchase again increased slightly to 4.4% on the year. In line with the stable consumer sentiment, the positive development in consumer credit seen over the past few quarters consolidated, providing additional support to loans to households. Besides the sound income situation, the persistently high demand by households for bank loans in the reporting quarter was also spurred on by the still exceptionally favourable financing conditions. According to MFI interest rate statistics, interest rates for both housing loans and loans for private consumption remained close to their all-time lows despite slight increases.

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

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



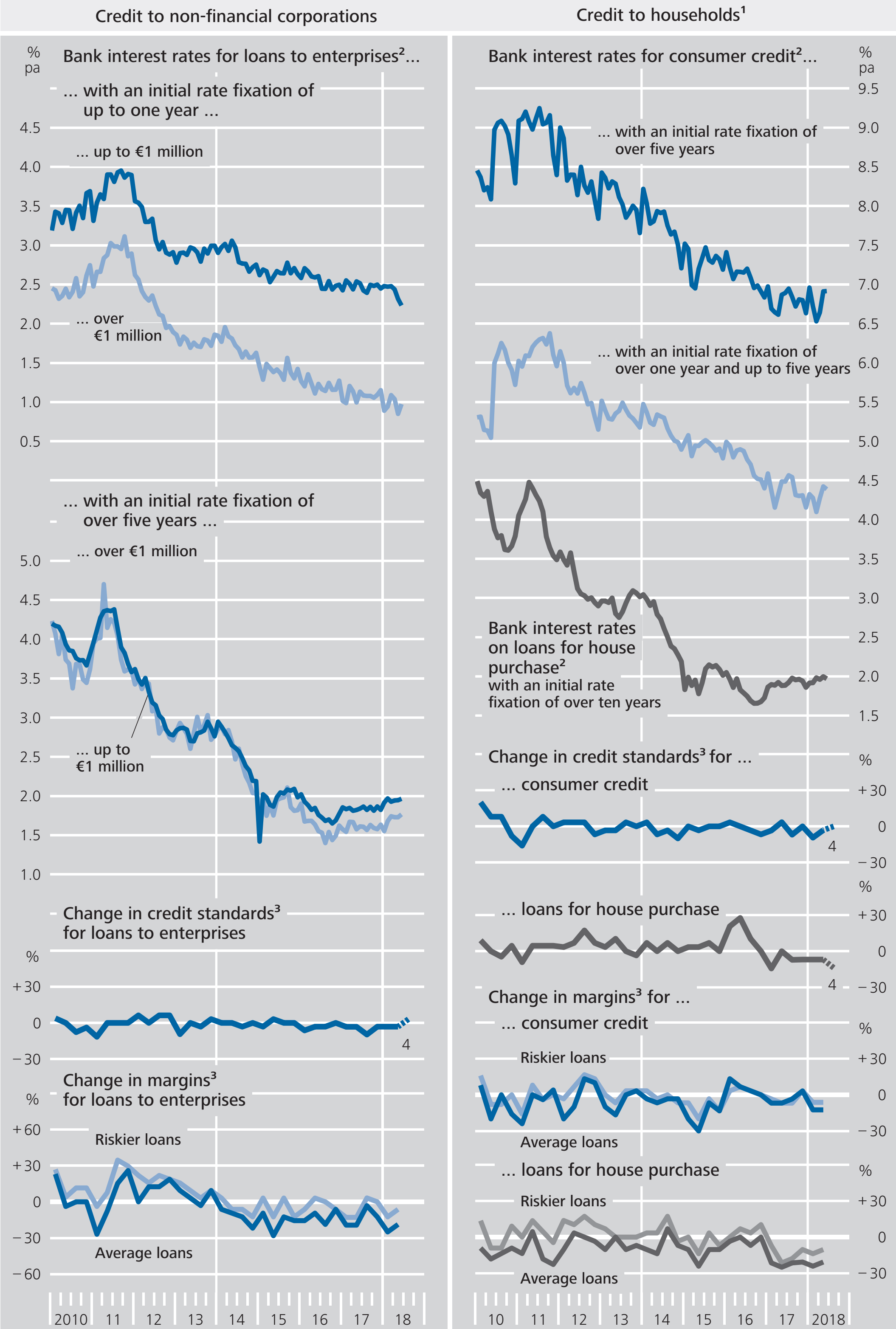
* Adjusted for loan sales and securitisation. **1** Non-financial corporations and quasi-corporations. **2** Including non-profit institutions serving households.
Deutsche Bundesbank

This was consistent with the banks surveyed in the BLS reporting that the rise in demand for loans to households for house purchase in the quarter ended was once again attributable to the low general level of interest rates, favourable housing market prospects and robust consumer confidence. By contrast, respondents reported that stifling effects on household demand stemmed mainly from the heightened use of households' own savings in the context of property financing and the loss of market shares to competitors. In the case of consumer credit and other lending, the banks chalked up the rise in demand to the low general level of interest rates, to households' stable propensity to purchase and to robust consumer confidence.

Lending policies for private construction and consumer finance support demand overall

Moreover, banks' expansionary lending policies supported demand for loans to households. Thus, credit standards for loans to households for house purchase were eased slightly for the fourth consecutive time, and the surveyed banks intend to lower their credit standards even further in the third quarter. In addition, banks somewhat eased the credit terms and conditions specified in the loan agreements with their customers. Here, the vast majority of the adjustments again occurred in the area of margins, which were narrowed considerably

Banking conditions in Germany



1 Including non-profit institutions serving households. 2 New business. According to the harmonised MFI interest rate statistics. Until May 2010, the aggregate interest rate was calculated as the average rate weighted by the reported volume of new business. As of June 2010, an interest rate weighted by the reported volume of new business is first calculated for each level. The aggregate interest rate is calculated by weighting the interest rates for the levels by the extrapolated volumes. 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 2018 Q3.

Deutsche Bundesbank

for average-risk loans, and markedly for riskier loans. Essentially, banks once again attributed the easing of standards and narrowing of margins to the high degree of competition.

The credit standards for consumer credit and other lending were eased marginally. Banks also eased their credit terms and conditions. On balance, the margins were thus narrowed markedly for average-risk loans and slightly for riskier exposures, while the other surveyed conditions remained virtually unchanged.

Further strengthening of banks' capital position in the first half of the year

As usual, the July survey of the BLS contained a number of *ad hoc* questions. Against the backdrop of the situation in the financial markets, German banks reported that their funding conditions had remained virtually unchanged compared with the previous quarter. As regards the effects of the new regulatory and supervisory activities, the surveyed banks stated that they had further strengthened their capital position in the first half of 2018. To answer the first-time question on the significance of various determinants for the level of credit margins in new business, the bank managers surveyed underlined – with regard to the first half of 2018 – the importance of intense competition, risk perception, cost of capital, compliance with the profitability targets of institutions and their operating costs. Competition, profitability targets and the cost of capital gained most in importance over the 2014 to 2017 period.

NPL ratio of German banks has no impact on their lending policies in the first half of 2018

For the first time, the latest BLS contained a question on the impact of non-performing loans (NPLs) on lending policies. According to the data provided by the surveyed German credit institutions, the NPL ratio (defined as the stock of gross NPLs on banks' balance sheets as a percentage of the gross carrying amount of loans) in the first half of 2018 had no impact on banks' credit standards or on credit terms and conditions, and banks do not expect any significant impact in the next six months either. By contrast, the banks reported that, when viewed in isolation, the NPL ratio in the reporting period from 2014 to 2017 had a slight tightening impact on credit standards for loans to enterprises and loans to households for house purchase, while it had only a marginal tightening impact on consumer credit and other lending. In addition, the NPL ratio *per se* marginally tightened credit terms and conditions for loans to enterprises. Compared with Germany, the NPL ratios of banks in the euro area led to a more pronounced tightening of lending policies. According to the participant banks, when viewed in isolation, the NPL ratio in the euro area overall had a slight tightening effect on credit standards and credit terms and conditions in the first half of 2018, and they expect similarly restrictive effects in the second half of the year as well. Furthermore, euro area banks reported that, for the period from 2014 to 2017, NPL ratios had a markedly restrictive effect on credit standards and a moderately tightening effect on credit terms and conditions.