

Monetary policy and banking business

Monetary policy and money market developments

ECB Governing Council twice raises key interest rates by 75 basis points

The ECB Governing Council decided to raise the three key ECB interest rates by 75 basis points at its meeting in September 2022 and by the same increment at its meeting in October. Those decisions took the interest rate on the deposit facility – currently the most important rate for money market rates – to 1.5% and the interest rates on the main refinancing operations and the marginal lending facility to 2% and 2.25%, respectively. Overall, the key interest rates have thus risen by 200 basis points so far since July. The Governing Council is expecting to raise interest rates further. It will base the future policy rate path on the evolving outlook for inflation and the economy, following its meeting-by-meeting approach.

Terms and conditions of TLTRO III modified

In view of the unexpected and extraordinary rise in inflation, the Governing Council decided furthermore in October to change the terms and conditions of the third series of targeted longer-term refinancing operations (TLTRO III). The interest rates payable by banks for TLTRO III operations are being adjusted with effect from 23 November 2022. From that date until the maturity date or early repayment date of each operation, the interest rate will be indexed to the average applicable key ECB interest rates over this period. Banks will be offered three additional voluntary early repayment dates.¹ The recalibration was carried out to ensure consistency with the broader monetary policy normalisation process and to reinforce the transmission of policy rates to bank lending conditions.

ECB adjusts remuneration of minimum reserves

Furthermore, the Governing Council adjusted the remuneration of minimum reserves held by credit institutions with the Eurosystem. In the future, minimum reserves will be remunerated at the interest rate on the deposit facility, rather

than at the main refinancing operations rate. This change aligns the remuneration of minimum reserves with money market rates.

The decisions in September and October were made because inflation remains too high and will stay above the 2% target for an extended period. In September, euro area inflation reached 9.9%. In recent months, soaring energy and food prices, supply bottlenecks and the post-pandemic recovery in demand have led to a broadening of price pressures. ECB staff made yet another significant upside revision to their inflation projections in September, raising them to 8.1% in 2022, 5.5% in 2023, and 2.3% in 2024. Risks to this inflation outlook are still tilted primarily to the upside, which is why monetary policy is aimed at reducing support for demand and guarding against the risk of a persistent upward shift in inflation expectations.

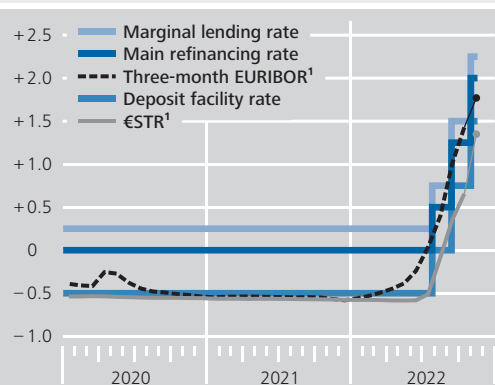
Inflation still far too high and set to persist above target for longer

The euro short-term rate (€STR) closed the period under review at 1.401%, which means it moved almost entirely in step with the two key interest rate hikes totalling 150 basis points during the reporting period. The three-month EURIBOR likewise continued to rise significantly,

€STR moves in line with policy rate hikes

Money market interest rates in the euro area

% p.a.



Sources: ECB and Bloomberg. ¹ Monthly averages. • = Average 1 to 18 November 2022.

Deutsche Bundesbank

¹ For further details, see European Central Bank (2022).

Money market management and liquidity needs

In the period under review from 27 July 2022 to 1 November 2022,¹ excess liquidity in the Eurosystem rose significantly by a total of €196.5 billion to an average of €4,657.7 billion. The interest rate hikes announced by the Governing Council of the ECB were the main driver of this increase. They pushed market interest rates up, which led to a decline in autonomous factors. The interest rate hike of 50 basis points in July saw excess liquidity initially rise by just €20.6 billion to €4,481.7 billion in the fifth reserve maintenance period of 2022 (July-September). Almost 90% of the total increase took place in the sixth reserve maintenance period of 2022 after interest rates were raised by 75 basis points in September.

Compared with the fourth reserve maintenance period of 2022, liquidity needs in the euro area stemming from autonomous factors fell by €238.1 billion to an average of €2,249.0 billion in the sixth reserve maintenance period of 2022. Liquidity in the banking system went

up as a result. This was mainly due to a decline in government deposits of €130.9 billion to €536.7 billion (with a decrease of €87.8 billion to €127.2 billion taking place in Germany). Liquidity was also boosted by a fall in net banknote issuance of €40.2 billion to €1,563.7 billion, which was unusual for the time of year. The decrease was largely explained by credit institutions dissolving the high cash balances they had previously held in order to avoid negative interest rates. Germany registered a sharp decline in banknotes issued of €24.8 billion to €894.7 billion. Moreover, the reduction in the combined total of net foreign assets and other factors, which are considered together owing to liquidity-neutral valuation effects, lowered liquidity needs by €65.7 billion. This was mainly due to

¹ Here, the averages of the sixth reserve maintenance period of 2022 (September-November 2022) are compared with the averages of the fourth reserve maintenance period of 2022 (June-July 2022).

Factors determining banks' liquidity*

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

| Item | 2022 | |
|--|--------------------|-------------------|
| | 27 July to 13 Sep. | 14 Sep. to 1 Nov. |
| I. Provision (+) or absorption (–) of central bank balances due to changes in autonomous factors | | |
| 1. Banknotes in circulation (increase: –) | + 18.7 | + 21.6 |
| 2. Government deposits with the Eurosystem (increase: –) | + 113.7 | + 17.2 |
| 3. Net foreign assets ¹ | + 6.4 | + 5.7 |
| 4. Other factors ¹ | – 91.2 | + 144.8 |
| Total | + 47.6 | + 189.3 |
| II. Monetary policy operations of the Eurosystem | | |
| 1. Open market operations | | |
| a) Main refinancing operations | + 0.7 | + 2.3 |
| b) Longer-term refinancing operations | – 24.5 | – 6.1 |
| c) Other operations | – 4.0 | – 6.5 |
| 2. Standing facilities | | |
| a) Marginal lending facility | + 0.0 | + 0.0 |
| b) Deposit facility (increase: –) | – 28.3 | – 3,783.0 |
| Total | – 56.1 | – 3,793.3 |
| III. Change in credit institutions' current accounts (I. + II.) | – 7.2 | – 3,604.1 |
| IV. Change in the minimum reserve requirement (increase: –) | – 0.5 | – 3.0 |

* 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.

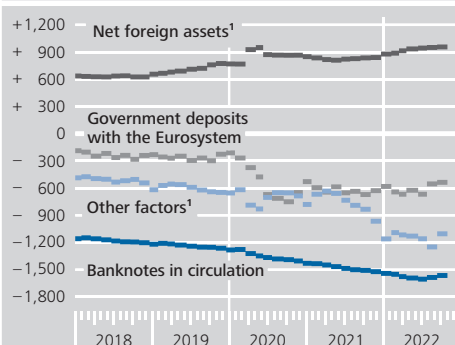
the drop in non-monetary policy deposits such as deposits by foreign central banks. By contrast, the minimum reserve requirement in the Eurosystem climbed by €3.5 billion to €164.4 billion in the period under review, thus further increasing the need for central bank liquidity. In Germany, the reserve requirement went up by just €0.4 billion to €44.3 billion.

Following the discontinuation of net purchases under the asset purchase programmes as of 1 July 2022, only reinvestments have taken place. Owing to revaluations, holdings of monetary policy assets decreased by €10.6 billion in the period under review. As at 14 November 2022, the balance sheet holdings of the asset purchase programmes amounted to €4,946.0 billion (see the adjacent table). The average outstanding tender volume in the euro area fell by €27.6 billion to €2,122.7 billion in the reporting period, resulting in net liquidity absorption. On 28 September 2022, a total of €8.3 billion out of all the targeted longer-term refinancing operations of the third series (TLTRO-III) was voluntarily repaid ahead of schedule. Moreover, during the period under review, liquidity amounting to €1.9 billion was repaid at maturity under the pandemic emergency longer-term refinancing operations (PELTROs). The volume in the regular main refinancing operations and three-month tenders remained at a very low level. However, demand increased slightly in both, particularly in the context of early TLTRO-III repayments. In Germany, the outstanding volume of all refinancing operations fell by €8.0 billion to an average of €401.4 billion of late owing to these early repayments. German banks' share in the outstanding volume of Eurosystem refinancing operations was thus around 18.9%, which was almost unchanged from the June-July 2022 reserve maintenance period.

Since the negative interest rate on the deposit facility was reversed on 27 July 2022, the two-tier system for the remuneration of excess reserves has effectively ceased to have any impact. The ECB Governing Council subsequently changed the multiplier for determin-

Autonomous factors in the Eurosystem*

€ billion, mean values for the relevant reserve maintenance period



Sources: ECB and Bundesbank calculations. * Liquidity-providing (liquidity-absorbing) factors are preceded by a positive (negative) sign. ¹ Including end-of-quarter liquidity-neutral valuation adjustments.

Deutsche Bundesbank

Eurosystem purchase programmes

€ billion

| Programme | Change across the two reserve periods | Balance sheet holdings as at 11 Nov. 2022 |
|--------------------------------------|---------------------------------------|---|
| Active programmes¹ | | |
| PSPP | + 0.7 | 2,587.5 |
| CBPP3 | - 1.2 | 303.3 |
| CSPP | + 0.1 | 344.7 |
| ABSPP | - 1.6 | 23.8 |
| PEPP | - 8.3 | 1,683.9 |
| Completed programmes | | |
| SMP | - 0.1 | 2.8 |
| CBPP1 | + 0.0 | 0.0 |
| CBPP2 | - 0.2 | 0.0 |

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

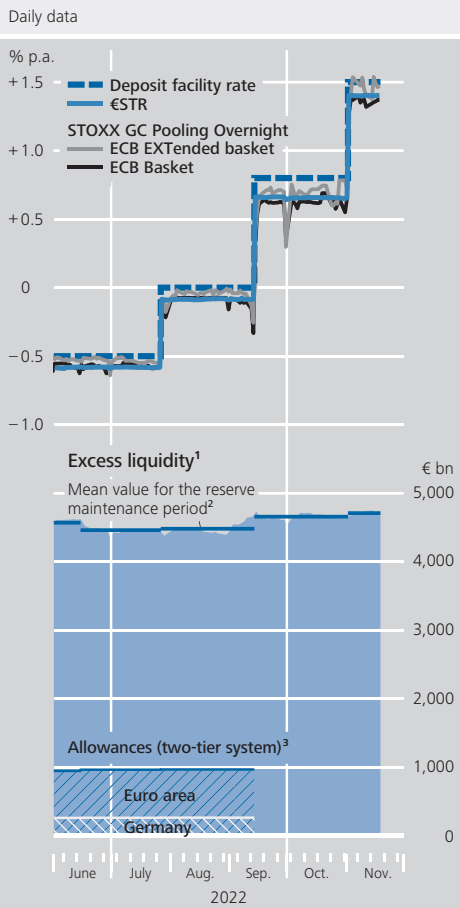
Deutsche Bundesbank

ing the exemption allowances from six times the minimum reserve requirement to zero with effect from 14 September 2022.

By contrast, the use of the deposit facility showed significant changes from 14 September 2022 after its interest rate was increased to 0.75%. As a result, on average around 96% of the Eurosystem's excess liquidity (94% in Germany) was held in the deposit facility in the September-November 2022 reserve maintenance period.

After the Eurosystem raised its key interest rates by 50 basis points in July and 75 basis points in September, overnight rates in the euro money market went up in the fifth and

Deposit facility rate, money market rates and excess liquidity



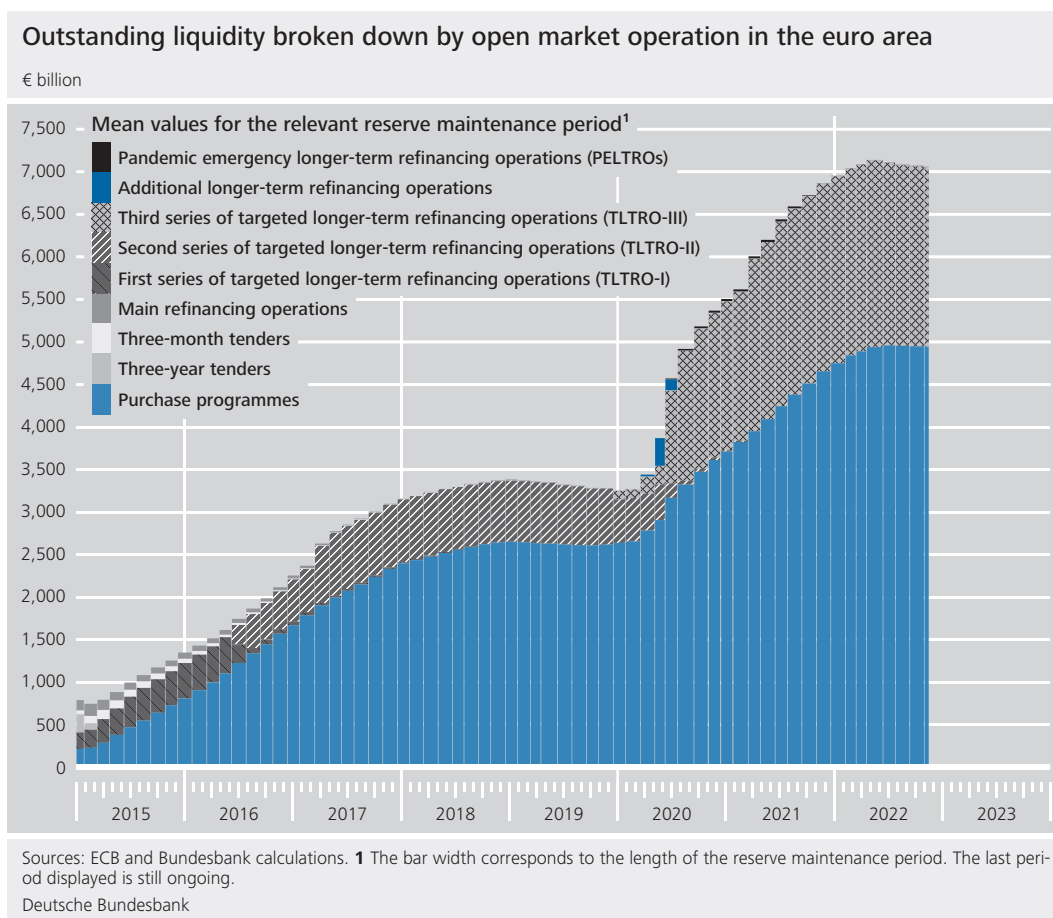
Sources: ECB, Eurex Repo and Bundesbank calculations. **1** Central bank balance minus the minimum reserve requirement plus the deposit facility. **2** The last period displayed is still ongoing. **3** With effect from 14 September 2022, the ECB Governing Council set the multiplier for the exemption allowance to zero.
 Deutsche Bundesbank

sixth reserve maintenance periods of 2022 (see the chart above). In both the fifth and sixth reserve maintenance periods of 2022, the unsecured euro short-term rate (€STR) mirrored the policy rate increases almost exactly, rising to -0.09% and 0.66% on an average in the respective periods. The spread on the deposit facility rate widened slightly by 1 basis point to 9 basis points off the back of the interest rate rises. At €53.9 billion on average, €STR turnover in the fifth reserve maintenance period of 2022 was only marginally higher than in the previous period. On 14 September, the first day of the sixth reserve maintenance period of 2022, turnover reached a new peak of €80.0 billion and remained at a high level thereafter. In keeping with this,

average turnover in the sixth reserve maintenance period of 2022 rose markedly by €10 billion to €63.9 billion.

On the GC Pooling trading platform, too, interest rates for overnight transactions in the ECB basket were almost fully passed through after the first trading days of the new reserve maintenance period, i.e. with a slight lag. Trading was carried out at an average of -0.10% in the fifth reserve maintenance period of 2022. This was roughly 48 basis points higher than in the previous period. The increase was slightly smaller compared with the rise in interest rates during the sixth reserve maintenance period of 2022, when trading hovered at an average of 0.60%, or 70 basis points higher than in the previous period. In the ECB EXTended basket, which has a broader selection of securities with lower rating requirements for concluding repo transactions, overnight trading took place at rates of -0.05% and 0.67% during the reporting period. This was an increase of 48 basis points and 72 basis points compared with the respective previous period. A pattern of falling interest rates and fairly low volumes can still be observed toward the end-of-month dates. Turnover in the ECB basket stood at €2.2 billion, which was higher than in the previous period under review. In the ECB EXTended basket, on the other hand, it was somewhat lower at €2.5 billion. In the sixth reserve maintenance period of 2022, a technical migration took place on the GC Pooling trading platform, resulting in lower transaction volumes; prior to this, turnover had been showing signs of an increase.

So far, in the current, seventh reserve maintenance period of 2022, it appears that the third interest rate hike will be passed on almost completely in €STR once again.



closing the period at 1.803%, up by around 154 basis points on mid-August.

Money market forward rates pricing in further interest rate steps

Money market forward rates are continuing to signal expectations of further key interest rate hikes even after the two interest rate moves in September and October. For the next monetary policy meeting in December, market participants are fully pricing in an interest rate step of 50 basis points. The money market forward curve is currently expected to peak in mid-2023 at around 2.9%, significantly up on mid-August, in an indication that market participants are pricing in a further 90 basis points in interest rate hikes overall in the first half of 2023. The forward curve remained highly volatile, however, amid distinct uncertainty, hovering between 2.5% and 3.2% at its peak over recent weeks. The forward curve fell noticeably for some time following the Governing Council's meeting in October, with market participants seemingly interpreting the monetary policy communication initially as if the risk of a

downturn in the economy was being assigned increasing importance in the Eurosystem's reaction function. The forward curve picked up again, though, on the release of euro area inflation figures for October that once again exceeded expectations. The path of inflation underlined the need for continued decisive monetary policy adjustment to preserve price stability over the medium term.

Participants in the ECB Survey of Monetary Analysts conducted ahead of the September and October meetings were likewise expecting further interest rate increases. In particular, respondents to the survey conducted prior to the October meeting were expecting a median of a 50 basis point interest rate hike in December and further interest rate steps in the first half of 2023 up to a deposit facility rate of 2.5%.

More interest rate hikes expected, surveys show

Net purchases under the pandemic emergency purchase programme (PEPP) and asset purchase programme (APP) were discontinued at

Little change in securities holdings

the end of the first and second quarters, respectively, with monetary policy securities holdings showing little change since then. Aggregate holdings reported under both purchase programmes are now being influenced only by the smoothing over time of reinvestments and by the use of amortised cost accounting.² On 11 November, the Eurosystem held assets totalling €3,258.7 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 PEPP came to €1,683.6 billion on the same day. The Governing Council will continue to apply flexibility with regard to PEPP reinvestments, with a view to countering risks to the monetary policy transmission mechanism related to the pandemic.

Excess liquidity increased

Excess liquidity has risen by around €253 billion since mid-August, lifting the volume of excess liquidity to €4,731.9 billion at the end of the period under review. The increase was due to a significant decline in autonomous factors (see the box on pp. 26 ff.). Voluntary repayments under TLTRO III, meanwhile, were low in the reporting period and had hardly any effect on excess liquidity. On aggregate, banks made early repayments of €6.5 billion on 28 September and a further €1.8 billion matured, thus leaving €2,121.7 billion still outstanding under the third series of TLTROs. Voluntary repayments are likely to be higher as of mid-November due to the modification of the TLTRO terms and conditions. This would help to reduce the Eurosystem balance sheet and, with that, contribute to the overall normalisation of monetary policy.

Monetary developments in the euro area

Monetary growth up in Q3

Influenced by the energy crisis and uncertain economic outlook, the broad monetary aggregate M3 expanded more strongly again in the third quarter than it had done in the two weaker preceding quarters, with the annual

growth rate rising to 6.3% at the end of September. One striking development on the components side was the significant growth in short-term time deposits, whose increased remuneration appears to have made this form of investment significantly more attractive. On the counterparts side, robust bank lending to non-financial corporations was a major contributor to monetary growth in the euro area. Two factors were behind non-financial corporations’ continued brisk demand for loans. First, there was weaker internal financing activity and ongoing supply bottlenecks in goods markets. Second, firms faced with significantly higher bond funding costs switched to currently less expensive loan-based financing. The banks surveyed in the Bank Lending Survey (BLS) reported that they had tightened credit standards across all loan categories, significantly so, in some cases. However, unlike in the case of loans for house purchase, the tighter financing conditions overall were not yet significantly dampening growth in loans to enterprises in the reporting quarter.

For the first time in years, it was the M3 component short-term time deposits, rather than overnight deposits, that registered the strongest inflows in the third quarter. Indeed, the build-up of time deposits has not been this substantial since mid-2008, and it extended across all sectors. Particularly noteworthy was the significant accumulation of time deposits by non-financial corporations, which proved to be exceptionally strong in September above all. Non-financial corporations’ overnight deposits, meanwhile, declined over the same period, in a sign that the reallocations may have been motivated by considerations of yield. Ultimately, these developments are probably a consequence of the key interest rate increases in July and September. Those hikes meant that there was no longer any reason to apply negative interest rates to large sight deposit holdings. At

Short-term time deposits in particular register inflows

² In particular, the difference between the acquisition and redemption value is amortised over the security’s residual maturity, treated as part of interest income and measured at amortised cost.

the same time, however, one-year to two-year time deposits in particular became a significantly more attractive form of investment for non-financial corporations because of the higher remuneration they offered.

Increase in money holdings also boosted by government transfers

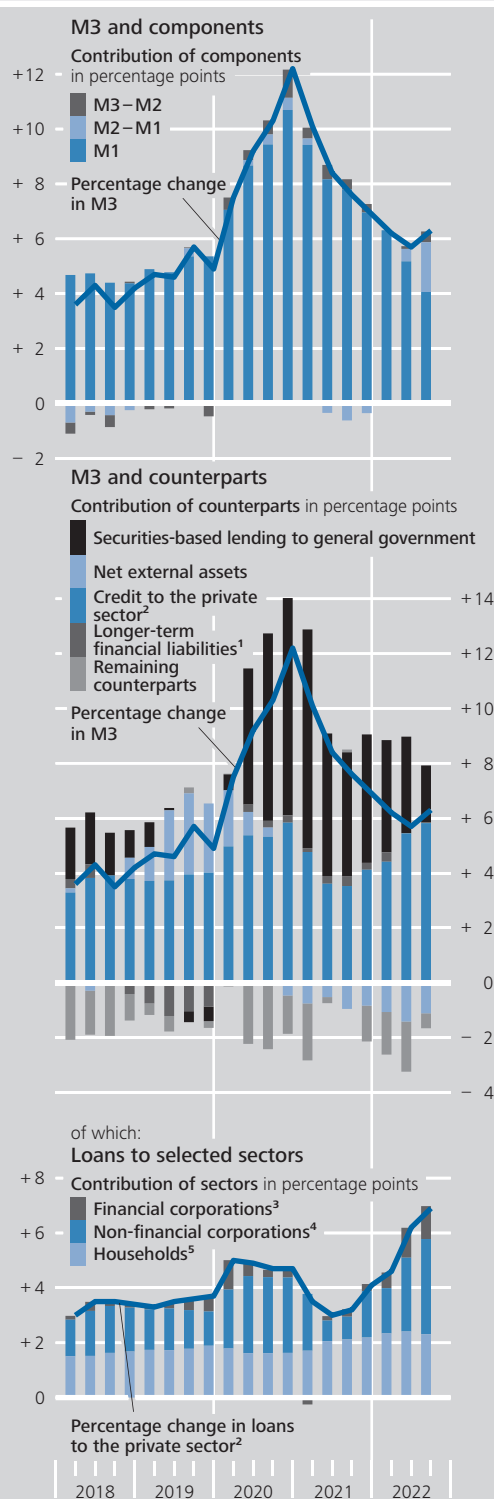
Because the remuneration of short-term time deposits did not become as attractive for households as it did for enterprises, the shifts observed in the household sector were not as significant. Households accumulated both overnight deposits and short-term savings deposits on balance and – for the first time in years – built up a notable stock of short-term time deposits. The brisk growth in deposits was also boosted by government transfer payments credited to the accounts of households and enterprises. This was offset by central governments of Member States, whose claims on the MFI sector do not count towards the money supply, reducing deposits on a large scale.

Strong accumulation of loans to non-financial corporations, mainly to cover increased costs for intermediate inputs and energy ...

On the counterparts side, it was above all loans to the private sector that drove monetary growth in the third quarter. As before, loans to non-financial corporations accounted for the bulk of this growth, with their annual growth rate climbing to just under 9% at the end of the quarter. Short-term loans, in particular, continued their robust growth on the back of further increases in the cost of working capital and intermediate inputs. Medium-term and long-term loans increased significantly as well, but this did not come as a result of buoyant investment activity. Rather, the yields on corporate bonds rose more strongly than bank lending rates, prompting large firms in particular to switch their funding arrangements away from securitised lending to loans. In addition, government-sponsored large-volume loans to enterprises from the energy sector, issued mainly through KfW Group in Germany, exerted an influence on aggregate lending. These loans were granted to address higher energy costs and the associated increased margin requirements for futures transactions at energy exchanges.

Monetary aggregates and counterparts in the euro area

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



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

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

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

| Assets | Q2 2022 | Q3 2022 | Liabilities | Q2 2022 | Q3 2022 |
|---|---------|---------|---|---------|---------|
| Credit to private non-MFIs in the euro area | 207.5 | 201.6 | Holdings against central government ² | 17.1 | - 122.0 |
| Loans | 231.4 | 212.4 | Monetary aggregate M3 | 152.5 | 356.7 |
| Loans, adjusted ¹ | 248.6 | 216.2 | Components: | | |
| Securities | - 23.9 | - 10.8 | Currency in circulation and overnight deposits (M1) | 87.6 | 123.5 |
| Credit to general government in the euro area | 76.5 | - 52.3 | Other short-term deposits (M2-M1) | 37.2 | 185.4 |
| Loans | - 0.7 | 1.7 | Marketable instruments (M3-M2) | 27.7 | 47.8 |
| Securities | 77.2 | - 54.3 | Longer-term financial liabilities | 29.7 | - 3.1 |
| Net external assets | - 70.6 | - 1.7 | Capital and reserves | 53.2 | 50.7 |
| Other counterparts of M3 | - 14.0 | 84.1 | Other longer-term financial liabilities | - 23.4 | - 53.8 |

* 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

... but a decline in funding needs for fixed investment

These factors are also reflected in the results of the BLS, according to which the surveyed banks saw demand for loans to enterprises rise again in the third quarter. Bank managers mainly put this down to an increased need for funding for inventories and working capital. Demand for short-term loans increased accordingly, while longer-term loans remained roughly as sought after as before. Financing requirements for fixed investment declined for the second time in succession, with borrowers using the funds raised instead to also repay debt securities.

BLS banks tightened credit standards for loans to enterprises

The banks interviewed as part of the BLS reported furthermore that they had tightened their credit standards once again in the third quarter. The loan rejection rate was up on the quarter. As the main reasons for adjusting their standards, the banks cited perceived deteriorations in both the economic situation and outlook as well as in sector-specific and firm-specific factors. A further decline in risk tolerance was another factor in the tightening of credit standards. For the first time since 2020, deteriorations in the cost of funds and balance sheet constraints also exerted negative effects on lending. Compared with the impact of increased credit risk, these bank-related factors were of limited significance, however. The banks' view is supported by surveys conducted by the ECB and the European Commission,

which find that the respondent firms regard access to financing as one of the least pressing surveyed problems, despite the tightening of financing conditions.

Unlike non-financial corporations, households exhibited lower demand for loans in the third quarter than they had in the preceding quarters. This slowdown affected loans for house purchase in particular. At the end of the quarter, the annual growth rate for these loans declined to just over 5% and was thus ½ percentage point lower than one year ago. An important factor in this development is likely to have been the higher interest rates, which, at the end of the quarter, were just over 1 percentage point higher than at this time last year. The banks surveyed by the BLS also reported a considerable fall in the demand for housing loans, which they attributed to the higher interest rate level and lower consumer confidence.

Housing loans to households weaker than in previous quarters ...

An additional dampening factor is likely to have been the significant tightening of credit standards for loans to households for house purchase, as indicated by the BLS. The net share of banks that reported such adjustments was as high as it had last been during the financial crisis. The rejection rate likewise rose considerably compared with the previous quarter. The surveyed banks justified the stricter standards on

... credit standards tightened significantly according to BLS

the grounds of a perceived increase in credit risk. This was attributable not only to the deterioration in the general economic situation and the bleaker outlook in the housing market, but also to the decline in borrowers' creditworthiness. Furthermore, banks reported that increased financing costs, which reduced their margins, had had a restrictive effect on their lending policies.

Consumer credit and other loans to households see weaker growth

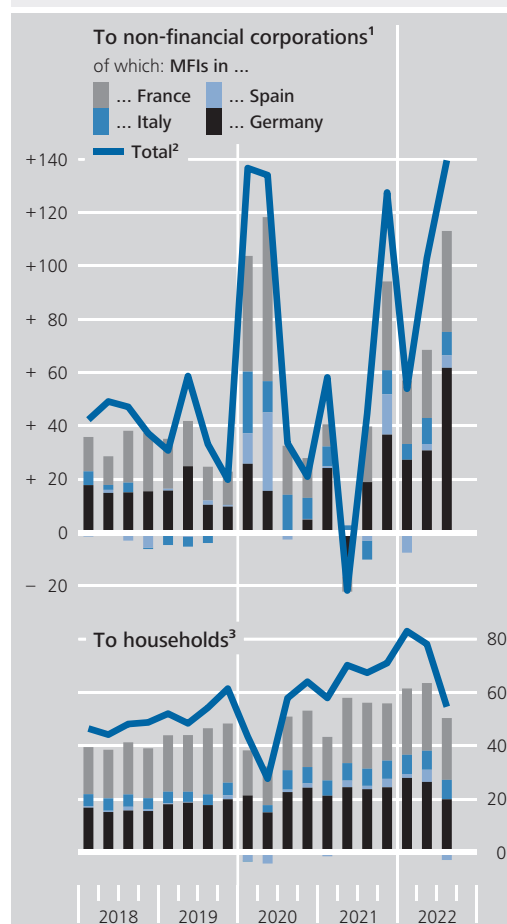
Similarly to loans for house purchase, consumer credit and other loans also saw weaker growth compared with the previous quarter. This is also reflected in the BLS: in the third quarter, the surveyed banks in the euro area reported a decline in the demand for consumer credit and other loans for the first time since the second year of the coronavirus pandemic. According to the banks that responded to the survey, the reasons for this fall in demand were, in particular, the higher general interest rate level, the decline in consumer confidence, and a lower propensity to purchase. At the same time, the number of surveyed banks that tightened their standards for consumer credit and other loans on balance was as high as it had last been during the first year of the pandemic. The rejection rate again rose compared with the previous quarter. As in the case of loans for house purchase, the banks justified this tightening based on their perception of greater credit risk.

End of purchase programmes reflected in securitised lending and net external position

The effect of securitised lending on monetary growth changed significantly following the Eurosystem's discontinuation of net purchases of government and corporate bonds at the end of June. For example, in the reporting quarter, the MFI sector markedly reduced its holdings of government bonds for the first time in three years. This was due to the fact that commercial banks domiciled in the euro area significantly reduced their holdings in the reporting quarter, while the Eurosystem only reinvested principal payments. The reduction in banks' securitised lending to euro area countries, when viewed in isolation, had a dampening effect on monetary growth. On balance, however, banks sold off

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

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



Sources: ECB and Bundesbank calculations. * Adjusted for loan sales and securitisation. **1** Non-financial corporations and quasi-corporations. **2** Also adjusted for positions arising from notional cash pooling services provided by MFIs. **3** Including non-profit institutions serving households.
 Deutsche Bundesbank

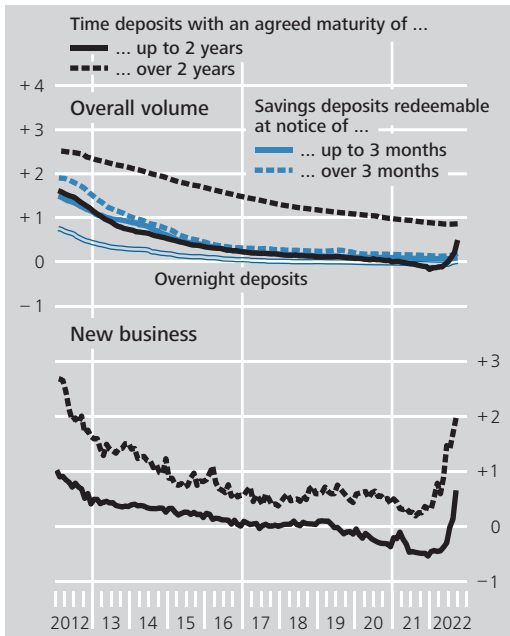
some of the securities to non-residents and thus improved their net external positions.

The discontinuation of net asset purchases and the hikes in key interest rates contributed to a rise in bond yields in the euro area. As a result, non-residents again purchased securities from euro area issuers, particularly government bonds. Despite the improved financial account balance, the net external position of the MFI sector was, however, balanced overall. This was due to the fact that the current account continued to deteriorate significantly. Against the backdrop of high prices for energy and

However, inflows in investment offset by outflows in current account

Interest rates on bank deposits in Germany*

% p.a., monthly data



* Deposits of households and non-financial corporations according to the harmonised MFI interest rate statistics (volume-weighted interest rates). Interest rate levels for overnight and savings deposits may also be interpreted as new business due to potential daily changes in interest rates.

Deutsche Bundesbank

commodity imports, the balance fell deeper into negative territory.

German banks' deposit and lending business with domestic customers

Deposit business characterised by rising interest rates and strong preference for liquidity ...

In contrast to the weak previous quarter, German banks' deposit business with domestic customers was exceptionally dynamic in the third quarter of 2022. Here, as in the euro area, the sharp uptick in interest for short-term time deposits among bank customers was particularly striking. At the same time, however, they also significantly increased their overnight deposits again. Furthermore, the reduction in long-term bank deposits was weaker than in many previous quarters. While the remuneration on these deposits, which had risen considerably in some cases, made them more attractive again for some bank customers, the current development of deposits in Germany

overall, however, indicates that bank customers' preference for liquid forms of investment has increased again in light of the tense economic sentiment and the uncertainty regarding the future consequences of the war against Ukraine.

The current growth in short-term deposits was driven by all money-holding sectors. Banks recorded the largest inflows in their deposit business with households, which, after four weaker quarters, started to build up overnight deposits once again. It appears that the considerably clouded economic outlook and high energy prices prompted households to hold more liquidity. Non-financial corporations, by contrast, increased their overnight deposits only marginally in net terms. Over the course of the quarter, in an environment of rising interest rates, they instead increasingly shifted their overnight deposits into short-term time deposits with interest rates consistent with market conditions. One reason for the increased build-up of deposits in this sector is likely to have been enterprises' reluctance to invest in fixed assets in light of the uncertain outlook. As all other money-holding sectors also recently increased their short-term time deposits, such deposits made strong gains overall in the third quarter.

... and driven by all money-holding sectors

Despite the tighter financing conditions, banks' lending business with domestic non-banks continued to expand substantially in the third quarter of 2022, following exceptionally dynamic growth in the previous quarter. In this context, banks again massively expanded their lending to the domestic private sector and also increased their holdings of securities from domestic private issuers to a greater extent. By contrast, lending business with the public sector contracted markedly again. Against the backdrop of low new issuance, banks continued to reduce their holdings of German government securities in particular. The low financing needs of German public sector budgets are likely to be connected not least to high tax

Renewed very strong momentum in lending business with non-banks

receipts resulting from the general price inflation, amongst other factors.

Demand for loans among non-financial corporations exceptionally high ...

The main reason for the robust lending to the private sector was the fact that non-financial corporations took out an exceptionally large volume of loans with domestic banks. Here, short-term loans with maturities of up to one year saw especially strong growth. Medium-term and long-term loans also rose sharply in the third quarter, however.

... bolstered by government assistance loans

A large portion of the net lending in corporate lending business was attributable to government assistance loans to energy companies that were granted directly by KfW Group. These loans mainly served to stabilise energy importers and suppliers that were facing liquidity bottlenecks owing to the surge in energy prices. However, even without the government-guaranteed assistance loans, corporate lending business was buoyant in the third quarter. First, non-financial corporations' internal financing options recently became considerably restricted and enterprises then had to increasingly turn to external financing sources. Second, for enterprises with existing long-term financing needs, it is currently cheaper to obtain funding via bank loans than via the capital market.

Loan demand driven by greater funding needs for inventories and working capital, amongst other factors

The responses to the most recent BLS suggest that other factors were at play as well. Bank managers again cited funding needs for inventories and working capital as a major reason for the increased demand for loans to enterprises. According to the bank managers, demand increased due to the fact that many enterprises expanded their inventories in light of the unstable supply chains and the expectation of rising costs.

Credit standards and terms and conditions tightened once again

At the same time, the banks surveyed by the BLS made their credit standards for corporate lending more restrictive on balance and also reported stricter credit terms and conditions overall. They pointed to the rise in credit risk as the main reason for this tightening. Similarly to the euro area as a whole, they primarily attrib-

MFI* lending and deposits in Germany

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

| Item | 2022 | |
|--|------|------|
| | Q2 | Q3 |
| Deposits of domestic non-MFIs¹ | | |
| Overnight | 4.5 | 44.6 |
| With an agreed maturity of up to 2 years | 13.3 | 65.3 |
| over 2 years | -6.9 | -1.3 |
| Redeemable at notice of up to 3 months | -2.9 | -8.1 |
| over 3 months | -0.7 | -0.3 |
| Lending | | |
| to domestic general government | | |
| Loans | -0.1 | -0.1 |
| Securities | -9.0 | -8.2 |
| to domestic enterprises and households | | |
| Loans ² | 62.4 | 78.0 |
| of which: to households ³ | 26.2 | 19.8 |
| to non-financial corporations ⁴ | 26.9 | 55.9 |
| Securities | -0.8 | 12.9 |

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

Deutsche Bundesbank

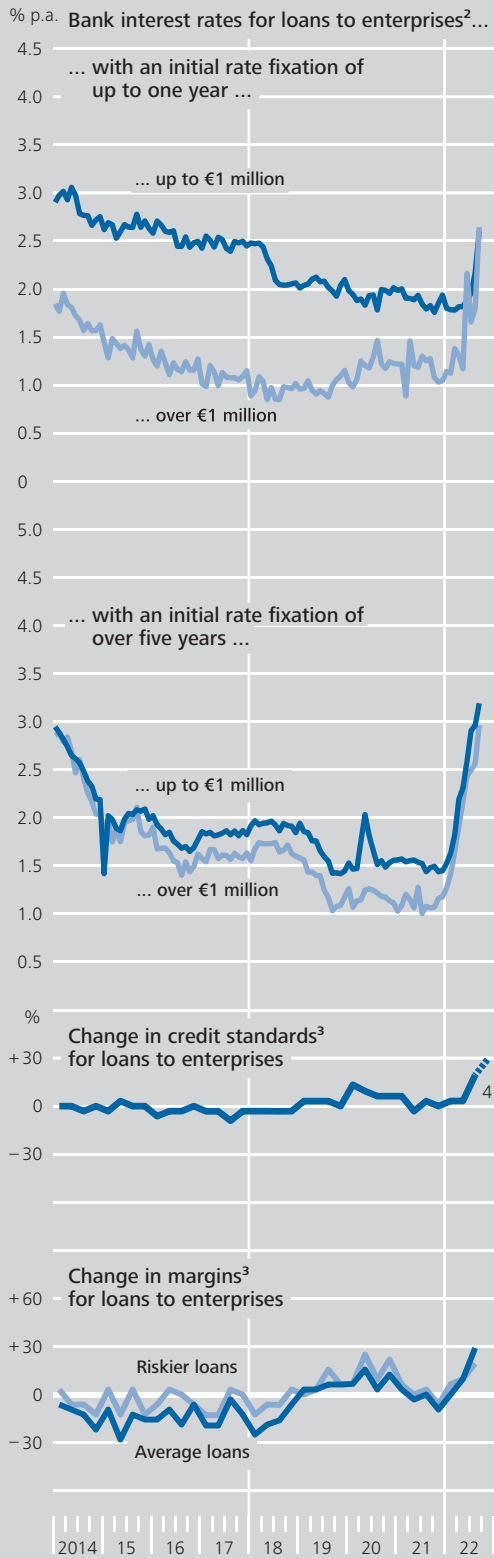
uted this rise to the deterioration in the general economic situation and economic outlook, particularly as a result of the war in Ukraine and rising energy costs, but also to sector-specific and firm-specific factors. In addition, their reduced risk tolerance also had a restrictive effect. The proportion of rejected loan applications in corporate lending likewise grew during the reporting period compared to the previous quarter.

Alongside lending to enterprises, banks in Germany also recorded significant growth in lending to households during the third quarter. This was again driven by loans for house purchase, although growth in these loans slowed down noticeably for the first time in several years. The loss of purchasing power, considerably higher construction prices, and the sharp rise in financing costs dampened households' demand for loans for house purchase. Overall, the annual growth rate of loans taken out for house pur-

Noticeably weaker growth in loans for house purchase

Banking conditions in Germany

Credit to non-financial corporations



Credit to households¹



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 2022.

chase continued to decline, slowing to 6.4% from 6.9% in the previous quarter.

Financing conditions for housing loans significantly more restrictive

The supply side also had a considerably more restrictive impact in the third quarter. The tightening of credit standards for housing loans was even more pronounced than it was for corporate loans. According to the banks, credit terms and conditions were also made noticeably more restrictive. In addition, the rejection rate rose significantly compared with the previous quarter. Furthermore, banks increased their collateral constraints and non-interest rate charges and lowered their loan-to-value ratios and amounts of credit granted. The banks justified these stringent requirements primarily on the grounds of a perceived increase in credit risk. Alongside the deterioration in the general economic situation and the reduced creditworthiness of borrowers, this was also due to the bleaker outlook on the residential real estate market. In addition, some banks also cited their lower risk tolerance and increased costs related to their capital position.

According to the BLS, the credit standards and terms and conditions for consumer credit and other lending to households were also tightened in the third quarter of 2022. Nevertheless, as in the previous quarter, net lending in this segment remained slightly positive.

Hardly any change in funding environment of German banks

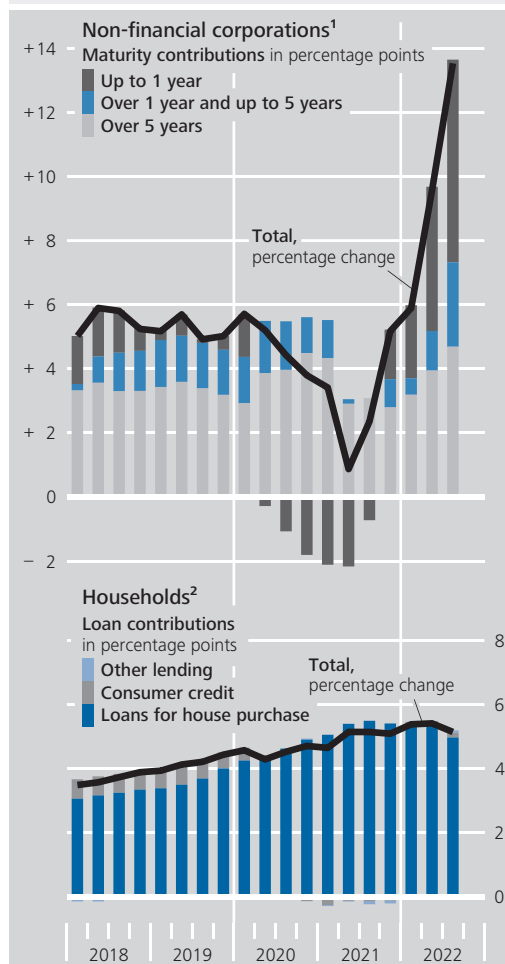
For the third quarter of 2022, the surveyed German banks reported that there was little change in funding conditions overall. According to the banks, the Eurosystem's asset purchase programmes (APP, PEPP) have contributed only marginally to improving their liquidity positions and market financing conditions over the past six months. On the other hand, the negative impact of the asset purchase programmes on banks' profitability also diminished significantly.

Continued positive effects of TLTRO III on banks' financial situations

By contrast, according to the banks, TLTRO III continued to have a visibly positive impact on their financial situations, despite the fact that no further operations have been conducted

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

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



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

since December 2021. The operations mainly contributed to increases in profitability, more comfortable liquidity positions, and improved financing conditions. They also contributed to improving the banks' ability to fulfil regulatory and supervisory requirements. The banks reported neither the asset purchase programmes nor TLTRO III as having a significant impact on their lending policies or volumes of lending over the past six months.

The negative interest rate on the deposit facility until 21 July 2022 led to a decline in lending and deposit rates and an increase in deposit fees over the past six months. Overall, it once

again squeezed banks' net interest income. The two-tier system for remunerating excess liquidity holdings did, however, soften the adverse impact on earnings.

■ List of references

European Central Bank (2022), Press release dated 27 October 2022, https://www.ecb.europa.eu/press/pr/date/2022/html/ecb.pr221027_1~c8005660b0.en.html