Money market conditions and remuneration of government deposits

Traditionally, the public sector has held only small deposits on accounts with the Bundesbank, deterred mainly by the interest arrangements. The Bundesbank's zero interest rate policy for account balances meant that the public sector was usually better off holding liquid funds on interest-bearing accounts with commercial banks or investing them in other ways in the money market.

In June 2014, the interest rate on banks' account balances was lowered into negative territory. In line with Eurosystem regulations, remuneration of government deposits held with the Bundesbank was also generally negative – charged at the interest rate on the Eurosystem's deposit facility (deposit rate). However, interest rate conditions for these deposits only deteriorated in absolute terms, i.e. in terms of their level. Compared with market conditions, it became increasingly attractive for the public sector to hold liquid funds with the Bundesbank.

In the years thereafter, large-scale monetary policy asset purchases by the Eurosystem led to an unprecedented rise in excess liquidity held by banks. At the same time, general government deposits at the Bundesbank likewise went up sharply. As a result of the monetary and fiscal policy measures taken in response to the coronavirus pandemic, account balances increased again as the pandemic progressed – to more than twice their previous levels.

The deposit rate was raised back into positive territory in September 2022, thus prompting the question as to what this would mean for interest arrangements for public sector deposits going forward. Maintaining the previously applicable zero interest rate on these balances would have likely led to extensive liquidity flows into the money market in the short term. This could potentially have contributed to lower interest rates amid increased volatility in various money market segments. Against this background, the Eurosystem – taking market conditions into account – permitted national central banks to pay a positive interest rate on government deposits – initially for a limited period until April 2023. As of May 2023, the maximum permissible interest rate on account balances will then be reduced by 20 basis points (measured in terms of market conditions) until further notice.

The account balances that general government holds with the Bundesbank have now fallen significantly. To a certain extent, account holders again have attractive options to invest in the market. The public sector is therefore likely to continue shifting liquid funds from the Bundesbank to commercial banks in the second quarter as interest rate incentives improve. Reducing the Eurosystem balance sheet helps to limit the risk of this foreseeable and desirable development having an adverse impact on money market conditions.

The Bundesbank advocates reinstating the zero interest rate policy for government deposits further down the line. This policy gives due account to the fact that such deposits do not fulfil an autonomous monetary policy function. Account management for public sector players is just one of a range of services offered by the Bundesbank for private and public banks in addition to its mandate to support and safeguard the fulfilment of public sector activities.

Introduction

Public sector account balances increasingly shifted to Bundesbank

Short-term account balances play an important role in the cash management of public administrations. They enable public authorities to offset fluctuations in revenue and expenditure and, if necessary, to make significant payments at short notice. In recent years, the public sector in Germany has increasingly shifted liquid funds from interest-bearing accounts at commercial banks or from other money market investments to accounts held at the Bundesbank.[1]

Bundesbank's role as fiscal agent

As part of its statutory mandate, the Bundesbank is the government's fiscal agent and offers various services to the public sector, including, in particular, account management and the settlement of payment transactions.[2] This means that not only commercial banks[3] but also public administrations, as well as both private-law and public-law entities[4] that perform duties of public administrations or process payments for public administrations, can hold an account at the Bundesbank. At the end of the day, public sector accounts with the central bank must always be at least balanced.[5]

General government deposits with Eurosystem central banks have no monetary policy function

In addition to monetary policy considerations and market economy principles, the prohibition on monetary financing (Article 123 TFEU) prevents central banks from remunerating government deposits at a higher rate than the comparable market conditions.[6] Comparable market interest rates are therefore an important point of reference for the maximum interest rate on public sector account balances with Eurosystem central banks. For the public sector, the possibility of holding balances on the central bank account is, in principle, only a supplement to services offered by commercial banks and other investments in the money market. General government deposits with the central bank have no monetary policy function: as a rule, the interest arrangements for public sector accounts are not part of money market management under the Eurosystem's monetary policy. From a monetary policy perspective, short-term interest rates can be managed without having to pay a positive interest rate on government deposits.

Central banks' duties as fiscal agents must take account of monetary policy requirements

At the same time, the national central banks' duties as fiscal agents should not impede the Eurosystem's performance of monetary policy tasks or the achievement of its price stability objective. Against this background, it has traditionally sought to counter excessive growth and unnecessary fluctuations in general government deposits.[7] This facilitates the Eurosystem's liquidity management and, with it, implementation of the single monetary policy. In light of this, the Eurosystem has tended to refrain from positively remunerating such balances with a view to setting incentives for deposits to be placed in the market. Thus, until negative key interest rates were introduced, public sector deposits with Eurosystem central banks reflected, in particular, the need for central bank account balances in public cash management including payment transactions.

ECB decisions regarding remuneration of government deposits

Since February 2014, the ECB Guideline on domestic asset and liability management oper-

1 Other euro area Member States have experienced comparable developments in many cases, but these are not the focus of this article.
2 See Deutsche Bundesbank (2016), Section 10.3 "Services for the public sector".
3 See also Deutsche Bundesbank (2022a).
4 These include, for example, social security funds and other public-law entities.
5 See the General Terms and Conditions of the Bundesbank, Section IV and the Bundesbank Act, Section 20.
6 In principle, the risk aspect should also be taken into account here, as account balances with the central bank are entirely default-free. Deposits with commercial banks may be subject to risk in individual cases, especially as public sector deposits are not covered by the deposit guarantee scheme.
7 As an "autonomous factor", general government deposits affect the level of central bank account balances held by banks: an increase in general government deposits with the Eurosystem usually results in a decrease in banks' account balances (and vice versa).

ECB Guideline regulates remuneration of government deposits

ations by the national central banks[8] has regulated the remuneration of government deposits. The ECB Governing Council initially set the market rate (for unsecured overnight deposits) as the absolute ceiling for the remuneration of (overnight) government deposits with Eurosystem central banks. As a general rule, each national central bank may apply the market rate only to relatively small account balances of up to 0.04% of the gross domestic product of the Member State in which that national central bank is domiciled (or up to €200 million, if this is higher). Beyond this threshold, a zero interest rate is generally applied if the deposit facility rate (deposit rate) is zero or higher. When the deposit rate was lowered into negative territory in June 2014, the ECB Governing Council specified that the deposit rate would likewise serve as the ceiling for remunerating government deposits (beyond the threshold) in the event of a negative deposit rate.[9]

Temporary removal of 0% ceiling initially limited to end-April 2023 …

When the deposit rate was raised back into positive territory in September 2022, the ECB Governing Council initially allowed the positive remuneration of all public sector account balances with Eurosystem central banks, albeit only provisionally. In order to preserve the effectiveness of monetary policy transmission and safeguard orderly market functioning, it decided on 8 September 2022 to temporarily remove the 0% interest rate ceiling for remunerating government deposits. Instead, for the period up to 30 April 2023, the ceiling for the remuneration of government deposits remained at either the Eurosystem's deposit facility rate or the euro short-term rate (€STR), whichever was lower.[10]

… to prevent abrupt outflow of deposits into the market

The temporary removal of the interest rate ceiling in September 2022 was linked to concerns that an immediate transition to zero interest rates would lead to an abrupt outflow of deposits into the market. Such deposit outflows threatened to exacerbate the collateral scarcity that was emerging in some segments of the euro area repo market[11] and thus run counter to monetary policy.[12]

Greater market intermediation nevertheless desirable

The ECB combined the transitional arrangement, initially limited until 30 April 2023, with a call urging public sector depositors to look for alternatives to central bank deposits, emphasising that the temporary change to remuneration does not alter the long-term desirability of encouraging market intermediation.[13]

Aim: gradual reduction of deposits

In February 2023, the ECB Governing Council decided to readjust the ceiling for remunerating certain deposits as of 1 May 2023.[14] The new ceiling for the remuneration of government deposits is to be set at the €STR minus 20 basis points, taking effect on 1 May 2023. According to the ECB, this change reflects the fact that, while conditions in the repo market have improved since September 2022, the market remains fragile. It believes that it is still important for these deposits to return to the market in a gradual manner and sees the changes to the remuneration regime as providing incentives for depositors to gradually run down their holdings with the Eurosystem. The ECB Governing Council announced that it stands ready to make further adjustments to the remuneration regime if necessary.[15]

As a result, monetary policy and non-monetary policy counterparties with a central bank account have been, and still are, subject to divergent (interest) conditions which set different incentives for their respective money market activity and have also shaped the development of

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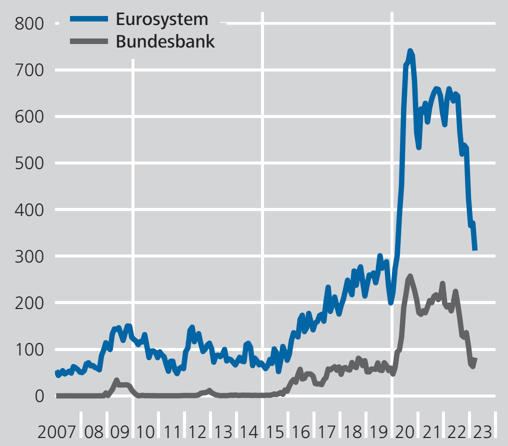
8 Guideline ECB/2014/9, last replaced by ECB/2019/7 (recast).
9 Certain deposits related to adjustment programmes (of the European Stability Mechanism, the International Monetary Fund and EU institutions) are exempt from the negative interest rate.
10 For information on the application of rates at the Bundesbank, see p. 22.
11 The repo market is used to trade money market loans backed by securities. In repo transactions, the borrower sells securities for a – generally fixed – period of time and then repurchases them. This is known as a repurchase agreement or "repo".
12 See also Deutsche Bundesbank (2022b).
13 See European Central Bank (2022).
14 This decision also alters the remuneration of deposits held under the Eurosystem reserve management services (ERMS) framework.
15 See European Central Bank (2023).

General government deposits

€ billion, monthly averages of weekly data



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public sector account balances at the central bank in recent years.

Development of general government deposits: the Bundesbank and the Eurosystem as a whole

Hardly any noteworthy general government balances on Bundesbank accounts until 2015

In the early years of monetary union, general government held hardly any noteworthy balances on accounts with the Bundesbank. A temporary departure from this trend was the rise in balances in the wake of the 2008 financial crisis.[16] From the second half of 2015 onwards, there was a more lasting increase in general government balances on Bundesbank accounts (see the chart above).

Changes in interest rate conditions increased comparative appeal of central bank deposits

The main driver of this development was the increasingly attractive interest rate on balances with the central bank compared with alternative investments in the money market. In parallel with the ECB Governing Council's key interest rate decision of June 2014, deposits with the central bank were remunerated at the deposit facility rate, which entered negative territory at that point in time. From 2015 on, alternative investments in the secured money market were increasingly only possible at rates below the deposit facility rate (see the chart on p. 17) given the sharp trend growth of excess liquidity in the banking system caused, amongst other factors, by the Eurosystem's monetary policy asset purchases. The deterioration of interest rate conditions in absolute terms in the negative interest rate environment was accompanied by a relative improvement due to changes in interest arrangements: compared with prevailing market conditions, it became increasingly attractive for general government to hold liquid funds on Bundesbank accounts.

General government shifted liquid funds to the Bundesbank

Given the more attractive interest rate conditions, general government deposits with the Bundesbank grew from close to zero[17] in 2014 to an average of €57 billion in 2019. This development largely reflects the fact that individual entities shifted a significant volume of liquid funds to the central bank. In parallel, however, the general government sector in Germany continued to hold a significant volume of balances and time deposits with commercial banks. According to the consolidated financial statement of the Eurosystem, these increased from €196 billion to €247 billion over the same period.[18]

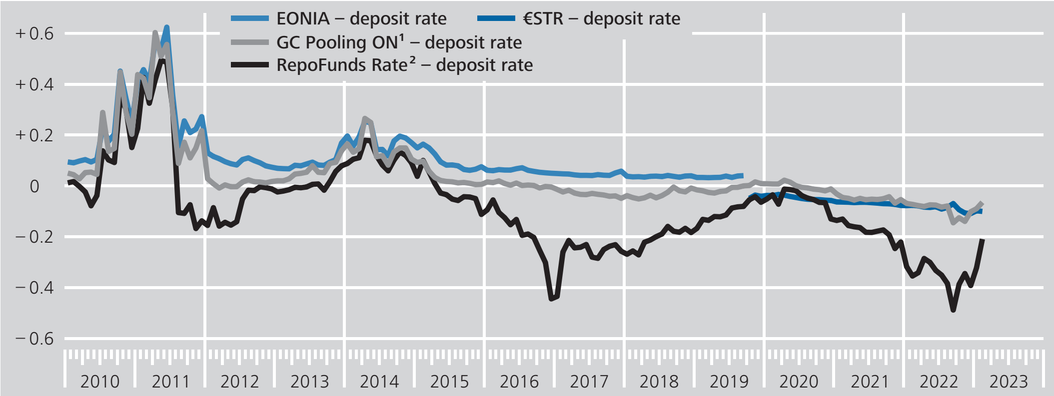
In connection with the coronavirus pandemic, general government then continued to rapidly and extensively build up its deposits with the Bundesbank, temporarily reaching up to €279 billion over the course of 2020 (see also the box on pp. 18 ff.).

In 2009, 2010 and 2012, the average level of general government deposits with Eurosystem

16 The 2008 and 2009 editions of the Bundesbank's Annual Report thus categorised deposits by the Financial Market Stabilisation Fund (SoFFin) as central government special funds. In May 2009, general government deposits briefly peaked at €36 billion.
17 General government balances held at the Bundesbank averaged €1 billion in 2014.
18 According to the consolidated financial statement, deposits with European banks by entities in the general government sector increased from €196 billion to €247 billion between the fourth quarter of 2014 and the fourth quarter of 2019, then fell slightly from 2020 onwards before rising to more than €280 billion over the course of 2022 (see https://sdw.ecb.europa.eu/quickview.do?SERIES_KEY=117.BSI.Q.U2.N.A.L20.A.1.DE.2100.Z01.E).

Interest rate spread of secured and unsecured money market rates over the deposit rate

Percentage points, monthly averages without quarter-end



Sources: Bloomberg and Bundesbank calculations. **1** Average interest rate of overnight transactions in the Eurex GC Pooling ECB Basket. **2** RepoFunds Rate Germany (repo trades using German government bonds as collateral executed on the BrokerTec or MTS platforms).

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Central bank deposits more attractive throughout the euro area given negative interest rate environment

central banks was already above €100 billion, reaching a temporary high of €174 billion in 2009. Due to changed interest arrangements with the transition to negative key interest rates and the trend increase in excess liquidity, general government deposits with the Eurosystem central banks rose from an average of €83 billion in 2014 to €258 billion in 2019. General government deposits with the Eurosystem central banks peaked at €810 billion in September 2020 during the coronavirus pandemic.[19]

Deposits reduced from mid-2022 onwards given signs of normalisation in interest rate conditions

Up to July 2022, general government balances with the Bundesbank and the Eurosystem central banks as a whole remained at an unprecedented historic high. With the prospect of the deposit facility rate returning to positive territory and interest rates then being less attractive in comparison, the general government sector began to rapidly withdraw or reduce its deposits. On balance, general government deposits with the Bundesbank had already receded to well below €100 billion in the first quarter of 2023. In parallel, general government balances fell to below €400 billion on aggregate across the Eurosystem.

Investment conditions for general government in the money market

Additional money market investments made possible by better money market conditions

In mid-2022, general government deposits at the Bundesbank began to fall. The foreseeable transition to positive deposit facility rates caused a relative improvement in market conditions from the investors' perspective and an increase in the availability of alternative forms of investment for the general government sector. Such alternatives include secured and unsecured investments in the money market. The German money market statistics show that, before the pandemic, entities assigned to the general government sector,[20] such as central government, state government and local government, as well as other institutional units such as public health insurers, held over €50 billion of unsecured investments in the money market. These declined slightly over the course of the pandemic, then rose again up to the beginning of 2023, temporarily exceeding €100 billion.

According to recent figures, Germany's general government sector has invested overnight de-

19 See Consolidated financial statement of the Eurosystem (25 September 2020).
20 Sector code S.13 according to the European System of Accounts (ESA).

The liquidity position of general government, taking the example of central government

From 2014 to 2019, central government did not need to take on any net new debt – borrowing was solely for the purpose of rolling over maturing Federal securities. Even in this environment, central government utilised short-term liquidity funding and made deposits[1] to balance its central bank account. According to the Federal Ministry of Finance, liquidity borrowing largely comprised secured borrowing, as this was subject to lower interest rates.[2]

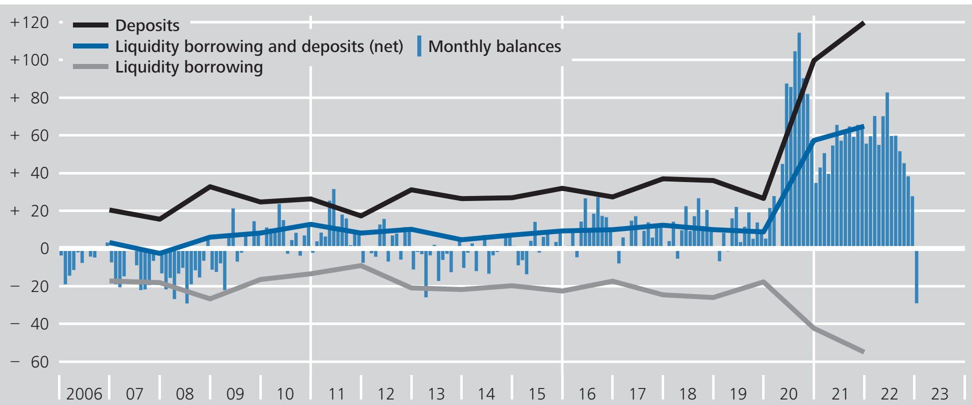
At the end of the 2014-19 period, deposits of roughly €30 billion were offset by recourse to liquidity borrowing of around €20 billion. The balance of liquidity borrowing and deposits, which is also calculated at monthly intervals, thus fluctuated in the range of €10 billion (see the chart below), meaning that deposits exceeded recourse to liquidity borrowing. A positive balance means that central government's deposits are either invested in the money market at least to this extent or are held as account balances with commercial banks or the central bank. In cases where the balance is positive, the size of the deposits is at least equal to the balance, but usually significantly higher. Outstanding liquidity borrowing reduces the balance but is not always utilised in full.[3]

It should be noted that, prior to 2015, central government held barely any deposits in the form of account balances with the Bundesbank. Instead, it placed liquid funds in the secured money market, amongst other things.[4] While large general government deposits were built up on the Bundes-

1 Essentially, this item encompasses central government's total cash holdings in connection with debt management. These include capital raised in the market, account balances held with commercial banks and balances on the Bundesbank account.
2 See, for example, Federal Ministry of Finance (2017), p. 45.
3 Even negative year-end balances were associated with significant deposits in the years after the turn of the millennium.
4 According to the Federal Ministry of Finance, short-term deposits predominantly take the form of repurchase agreements and are therefore secured (see https://www.bundesfinanzministerium.de/Content/DE/Standardartikel/Themen/Oeffentliche_Finanzen/Schuldenmanagement/schuldenmanagement-des-bundes.html).

Central government liquidity borrowing and deposits

€ billion



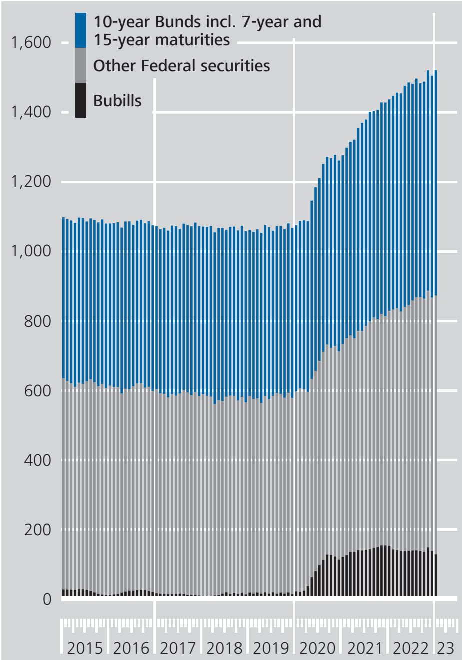
Sources: Federal Ministry of Finance and Federal Republic of Germany – Finance Agency.
Deutsche Bundesbank

bank's balance sheet between 2015 and 2019, the deposits reported by central government at the end of each year appear to be broadly constant compared with the period immediately prior to 2015. Against this background, it is reasonable to conclude that the increase in general government deposits between 2015 and 2019 is also attributable to transfers of account balances from the money market to the central bank balance sheet, as central government's liquidity position did not expand significantly during this period (see the chart on p. 18).

In order to counter the economic consequences of the coronavirus pandemic, general government provided extensive fiscal assistance starting in the spring of 2020. There was a high degree of uncertainty about the exact timing and the level of outflows. Against the backdrop of sharply increased but uncertain borrowing requirements, central government's holdings of liquid funds grew and the volume of liquidity borrowing permitted under the Budget Act was expanded.[5] In addition, the German Finance Agency – also covered by an adjustment in the Budget Act – increased its own holdings of Federal securities. These retained securities allow for more flexible market positioning on the part of the Finance Agency. The holdings are also available for securities repurchase agreements (repos) for financing purposes[6] or securities lending (with the aim of alleviating shortages in the securities markets). The Finance Agency's increased securities lending activity can be seen in the cash collateral accepted where the volume of both liquidity borrowing and short-term balances at the Finance Agency have gone up. However, a large part of the additional borrowing requirements was covered by a greater issuance of securities in all maturity segments. Central government's issuance of Federal

Financing of central government budget (incl. special funds): Federal securities

€ billion



Source: Federal Republic of Germany – Finance Agency. Deutsche Bundesbank

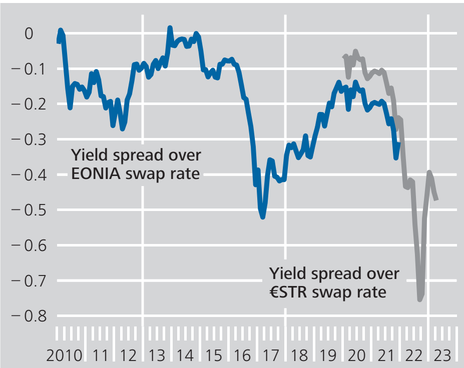
securities with maturities of up to one year (Treasury discount paper, or Bubills; see the chart above) saw a particularly sharp increase.[7]

Through these measures, a significant short-term liquidity reserve was built up. This is reflected, first, in the deposits in the Federal Ministry of Finance's financial statements and, second, in the significantly higher general government account balances held with the Bundesbank. Whether it was an investment at market interest rates or a deposit at the central bank, holding this liquidity reserve generated interest income for central government. The higher the share of funds held on the central bank account, the greater this income, as money market

5 See Federal Ministry of Finance (2021).
6 Since 2020, it has also been possible to use repo transactions to finance the budget beyond the end of the year.
7 See Federal Ministry of Finance (2022a).

Two-year Bund asset swap spread*

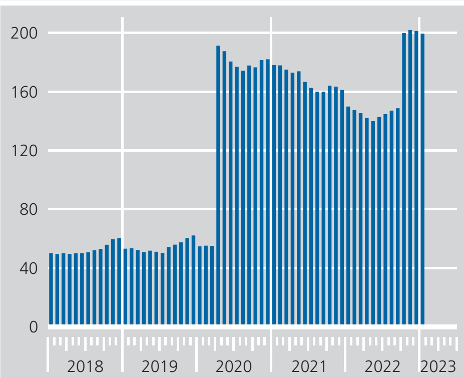
Percentage points, monthly averages



Sources: Bloomberg and Bundesbank calculations. * Difference between the two-year EONIA/€STR swap rate and the yield on a matched maturity Bund.
Deutsche Bundesbank

Central government's own securities holdings

€ billion



Source: Federal Republic of Germany – Finance Agency.
Deutsche Bundesbank

rates such as the €STR were lower than the deposit facility rate during this period.[8] Overnight borrowing backed by Bunds on the repo market was possible at rates well below the deposit rate applicable when placing the borrowed funds in the central bank account. The asset swap spread[9] of Bunds versus the €STR, i.e. the yield spread expected by the market between central government borrowing and daily investment of borrowed funds in the money market, was at times considerable for short-dated Bunds. Even at the start of 2023, the yield on two-year Bunds, for example, was significantly lower than the two-year €STR swap rate less 20 basis points. Under such circumstances, investing borrowed funds on the capital market at market conditions or depositing them in the central bank account would both be profitable transactions for the Finance Agency, all else being equal (see the upper adjacent chart).

As a result of the growing shortage of Bunds in the repo market, the Finance Agency has also considerably expanded its activities in this market (including securities lending) since 2020. The further increase in own holdings in October 2022 (see the lower adjacent chart) took place against the backdrop of "extraordinary financing needs […] as part of the Federal government's set of measures to address the energy crisis" and for use in repo market trading. The focus was on securities that were "particularly in demand in the current market environment".[10] A portion of central government's liquid funds is therefore likely to be attributable to repos – conducted to meet this demand and to avoid excessive fluctuations in repo rates – in which the Finance Agency borrows some funds in exchange for Federal securities.

8 Until the Euro Overnight Index Average (EONIA) was discontinued on 3 January 2022, the deposit facility rate was the relevant rate for the remuneration of central bank balances held by general government in the negative interest rate policy period; see Guideline ECB/2019/7.
9 The asset swap spread is the difference between the interest rate swap rate and the yield on a matched maturity bond. A Bund asset swap spread combines the purchase of a fixed interest Bund with an interest rate hedge using an interest rate swap and reflects not only demand for interest rate hedging but also the general liquidity situation. See also Deutsche Bundesbank (2022b).
10 See Federal Republic of Germany – Finance Agency (2022).

Some unsecured investments possible at rates above the €STR swap curve

posits totalling just under €20 billion in the unsecured money market. The interest rates on the vast majority of overnight deposits are already higher than the €STR minus 20 basis points – i.e. they are above the ceiling on remuneration predominantly relevant for general government deposits as of May 2023. In most cases, outstanding investments with longer maturities were even concluded with an interest rate above the €STR swap curve on the respective trading day. Larger entities such as state governments tend to be able to make investments with significantly higher rates than smaller entities such as local governments. In the general government sector, there is often a preference for investments at associated institutions such as Landesbanken or promotional banks.

Normalisation of conditions in secured money market segments

In various secured money market segments, too, short-term investments at rates above the €STR minus 20 basis points have become possible again. In the GC Pooling segment,[21] for example, the total volume invested in the overnight money segment has recently grown significantly – and at rates that are well above the Eurosystem's interest rate ceiling for remuneration of government deposits (excluding the year-end).[22] Furthermore, longer-term investments in this segment have proved possible again recently, which also points to increased market activity.[23] Since the beginning of the year, interest rates on investments backed by Federal securities have become comparatively attractive again, too. According to the German money market statistics, transactions concluded with rates above the €STR minus 20 basis points accounted for a significant share of the trading volume in this segment in February and March.

Interest rates on general government deposits in the current market environment

Transitional interest rates are intended to avoid an abrupt fall in secured rates

The Governing Council justified the initially positive remuneration ceiling for general government deposits by expressing its concern that, in the event of zero remuneration, the majority of these deposits might suddenly be withdrawn and shifted primarily to the secured money market. An abrupt outflow of deposits might have exacerbated the incipient collateral scarcity in some segments of the repo market because, from the perspective of general government, investing liquid funds in the repo market is a comparatively safe alternative to central bank deposits. This might have contributed to a further marked decline in repo rates (compared with the key interest rate level). Furthermore, this could potentially have spread to other secured and unsecured money market segments to an extent that was undesirable from a monetary policy perspective.[24] If certain secured money market rates had systematically fallen behind the key interest rate path, this would initially have counteracted the monetary policy tightening planned in autumn 2022. The ECB Governing Council therefore considered it necessary to adjust the remuneration ceiling in September 2022 in order to ensure the effectiveness of monetary policy transmission. This adjustment ultimately contributed to a slight

21 According to Eurex Clearing AG, individual entities in the general government sector also have access to the GC Pooling segment. A list of clearing participants with access to the GC Pooling segment can be found at https://www.eurex.com/ex-en/markets/eurex-repo
22 In the reserve maintenance period ending on 7 February, overnight money volumes averaged €4.1 billion in the ECB Basket and €3.9 billion in the ECB EXTended Basket, although trading volumes recorded on public holidays and at year-end were significantly lower. See Deutsche Bundesbank (2023a), p. 28. Furthermore, there were also notable daily trading volumes in the GC Pooling Tomorrow Next and Spot Next segments.
23 Recently, for example, the STOXX GC Pooling longer-term indices, which are based both on concluded transactions and on (binding) quotes, recorded enduringly positive index turnover (measured in € billion) for maturities of one week, one month or three months.
24 Possible mechanisms include evasive movements to neighbouring (collateral) segments of the secured money market, and transactions in the secured money market potentially being taken into account in the calculation of certain reference interest rates. Furthermore, zero remuneration on general government deposits might have made it more difficult for the Finance Agency to provide securities against cash collateral in the context of securities lending, which would also have reduced the supply of certain securities in the repo market.

easing in the secured money market, which continued over the first quarter of 2023.[25]

National central banks decide on implementation of interest arrangements

Within the ceilings established by the ECB Governing Council, the respective national central banks or the ECB set the remuneration on general government deposits. First, the decisions of the national central banks must take into account the objectives of the relevant decisions of the Governing Council. Second, based on the considerations already mentioned at the beginning of this article (including compatibility with market economy principles and the prohibition of monetary financing) and in the interest of proportionality, remuneration should only be as high as is necessary to achieve the specific objectives being pursued. In the period between September 2022 and April 2023, the Bundesbank is therefore remunerating general government deposits at the deposit facility rate minus 20 basis points or the €STR, whichever is lower. The remuneration set by the Bundesbank was thus mostly around 10 basis points below the remuneration ceiling put in place by the ECB Governing Council. In view of current market conditions, the remuneration on deposits applicable at the Bundesbank from May 2023 onwards with the remuneration ceiling set by the Governing Council, i.e. the €STR minus 20 basis points,[26] is also likely to provide the incentives now needed for a gradual and orderly transfer of deposits to the money market.

Conclusion

Money market conditions enabling balance sheet normalisation

General government deposits with the Bundesbank have now fallen back significantly from the highs reached during the coronavirus pandemic. To a certain extent, account holders now have attractive investment options in the market again. The general government sector is therefore likely to continue shifting liquid funds to commercial banks in the second quarter of 2023 given the growing interest rate incentives. The reduction of monetary policy asset holdings as part of the normalisation of monetary policy is instrumental in limiting the risk of this foreseeable and desirable development having an adverse impact on money market conditions.

Consider return to zero interest rates going forward

From the Bundesbank's perspective, it would make sense to reinstate the zero remuneration policy for general government deposits further down the line. This is appropriate given that these deposits do not fulfil a monetary policy function. Instead, carrying accounts for general government entities is a service offered by the Bundesbank which, in tandem with the services offered by private and public banks, supports and safeguards the fulfilment of general government tasks.

25 For example, the scarcity premium in the repo market declined and there was a slight fall in asset swap spreads; see also Deutsche Bundesbank (2022b).
26 See Deutsche Bundesbank (2023b).

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