

Box 1

DEVELOPMENTS IN SHORT-TERM DEBT SECURITIES WITHIN M3

When held by the money-holding sector, MFI debt securities issued with an agreed maturity of up to two years are one component of the broad monetary aggregate M3, and are recorded as part of marketable instruments (i.e. the difference between M3 and M2). These short-term debt securities currently account for only 2.4% of the outstanding stock of M3 (and 17% of the stock of marketable instruments in M3), but they have grown very strongly in recent months. In November 2006, their annual growth rate was 49.7%. As a result, the contribution of short-term debt securities to annual M3 growth has been relatively large of late, close to 1 percentage point in October and November 2006 (see Chart A).¹ This box briefly reviews the factors behind the developments in short-term debt securities within M3.

The growth of short-term debt securities has followed the business cycle

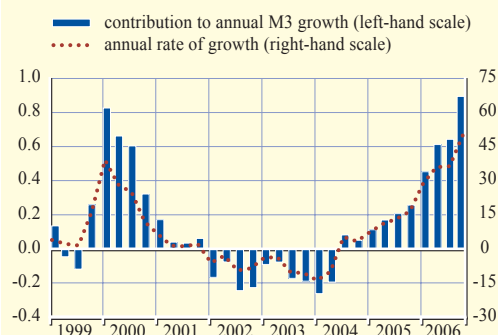
Chart A suggests that the evolution of the annual growth rate of short-term MFI debt securities since 1999 has broadly followed the business cycle. In particular, these securities are currently growing strongly in an environment of robust economic activity. A similar pattern was visible in 2000, i.e. during the previous period of strong economic growth. Moreover, when the expansion of economic activity was more subdued between 2002 and 2004, the stock of outstanding short-term debt securities shrank. When assessing this cyclical pattern, it is useful to review the various factors that may influence the demand for and the issuance of short-term debt securities.

The strong demand for short-term debt securities in 2000 and 2006 is likely to be related to the economic recoveries under way in these two periods. During an economic recovery, when cash flows are strong and new investment opportunities are emerging, corporations need to hold liquid instruments for transaction purposes. MFI short-term debt securities may be particularly

¹ As the annual growth rates and the contributions can be very volatile on a month-to-month basis, the charts in this box are based on quarterly data.

Chart A Developments in short-term MFI debt securities

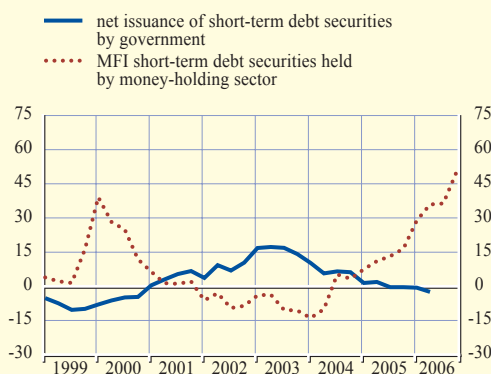
(percentage points; annual percentage changes; quarterly data)



Source: ECB.
Note: The data for the fourth quarter of 2006 refer to October and November.

Chart B Net issuance of short-term debt securities by government

(annual percentage changes)



Source: ECB.
Note: The data for the fourth quarter of 2006 for MFI short-term debt securities refer to October and November.

suitable in this respect, as the highest rated of such securities can be sold on the secondary market and, in some cases, are even issued with a sellback option. In this respect, it is likely that MFI short-term debt securities are predominantly held by large non-financial corporations and, to a lesser extent, institutional investors, given that these securities are typically issued in relatively large denominations and their management tends to be more complex than that of other monetary assets.² Economic recoveries are typically characterised by periods of rising short-term interest rates. Short-term debt securities may be particularly attractive in such periods, as they are mostly issued at floating rates and, unlike other instruments, thus allow investors to benefit from interest rate increases that occur before the maturity of the security.³

In line with the reasoning above, the subdued growth of short-term debt securities between 2002 and 2004 is likely to reflect the subdued economic activity and the relatively stable interest rates observed during this period. An additional factor may have been the then prevailing weakness of the banking sector, within which credit ratings were deteriorating. By contrast with MFI deposits, MFI debt securities are typically not protected from possible default of the MFI by a deposit insurance scheme. Thus, deposits may have made a more attractive investment during this period. Moreover, investors may have preferred purchasing securities with better credit ratings, such as government bonds, to purchasing MFI debt securities. As fiscal deficits rose between 2002 and 2004, the net issuance of short-term debt securities by governments increased, which may have enhanced the substitution out of MFI short-term debt securities (see Chart B). Since 2005, with stronger economic growth and rising tax receipts, the financing needs of the public sector have diminished somewhat and net issuance of government securities has therefore declined. Consequently, investors in short-term government debt securities have

2 This is suggested by the data on sectoral holdings of debt securities in the quarterly financial accounts. The reason why non-financial corporations might prefer debt securities to money market fund shares/units is that the remuneration of an MFI debt security is similar to that of a government debt security, while in the case of mutual fund investments the investor is charged with fees. Furthermore, an investment in debt securities enables investors to choose the preferred asset directly, whereas in the case of a mutual fund investment, this decision lies with the fund managers.

3 From the issuer point of view, issuing short-term debt securities at floating rates permits an easier quotation, and, if needed, hedging instruments against the interest risk are available on the interest rate swap market.

sought alternative assets and may have switched (back) to short-term MFI debt securities, which are a close proxy for short-term government debt.

Structural factors might also have played a role in the growth of short-term debt securities

Apart from these conjunctural factors, there may also be explanations of a more structural nature for the strong dynamics of short-term debt securities in recent quarters. This is suggested by the cross-country variation in the pickup of MFI short-term debt securities, with some euro area countries exhibiting strong growth rates well ahead of the time at which conjunctural factors, such as the economic recovery or the rise in short-term interest rates, suggested such a strengthening would take place. Moreover, the euro area countries that have contributed most to the rising contribution of short-term debt securities to annual M3 growth in recent quarters differ from those that contributed strongly in 2000. These observations suggest that there may have been structural factors at work – such as regulatory changes in the national markets – which, for instance, have changed the issuance policies of banks.

Overall, on the basis of currently available information, it is likely that the recent strength of growth in short-term debt securities is due both to conjunctural factors and to structural influences. In order to distinguish between these two sets of factors, it will be interesting to observe whether the buoyant developments in debt securities in recent quarters will unwind once the current interest rate tightening cycle is perceived to have come to an end, and, if they unwind, whether this happens via shifts into other components contained in M3 or via financial instruments outside M3.

MAIN COUNTERPARTS OF M3

On the counterparts side, the annual growth rate of MFI loans to the private sector remained unchanged at 11.2% in November. The ongoing robust demand for loans reflects both the low level of interest rates in the euro area and the strength of economic activity. At the same time, strong aggregate loan dynamics in November mask divergent sectoral developments.

The annual rate of growth of loans to households remained unchanged at 8.7% in November (see Table 2). The ongoing strength of lending to households continued to be largely attributable to borrowing for house purchase, which continues to be vigorous, despite a continuation of the downward trend in the annual growth rate observed since April 2006 (to 10.2% in November, from 12.2% in April). Developments in housing loans are likely to reflect a moderation in house price growth and housing market activity in a number of euro area economies over the course of 2006, as well as higher interest rates on loans for house purchase, which nonetheless remain at low levels by historical standards. The annual growth rate of consumer credit also declined further in November, to 7.9%, having stood at 8.0% in the previous month.

By contrast, the annual growth rate of MFI loans to non-financial corporations continued the upward trend observed since early 2004, rising to 13.1% in November, from 12.9% in October. This further strengthening was broadly based across loan maturities, which might reflect relatively favourable conditions for external financing via MFI loans. For further details, see Box 2 entitled “Factors underlying the strong acceleration of loans to euro area non-financial corporations”.

Table 2 MFI loans to the private sector

(quarterly figures are averages; not adjusted for seasonal and calendar effects)

	Outstanding amount as a percentage of the total ¹⁾	Annual growth rates					
		2005 Q4	2006 Q1	2006 Q2	2006 Q3	2006 Oct.	2006 Nov.
Non-financial corporations	41.7	7.7	9.2	11.0	11.9	12.9	13.1
Up to one year	29.7	5.2	6.7	8.4	9.2	10.6	10.8
Over one and up to five years	18.4	8.5	11.5	15.8	19.0	20.1	21.1
Over five years	51.9	8.9	10.0	11.0	11.2	11.8	11.8
Households²⁾	49.5	9.0	9.6	9.8	9.3	8.7	8.7
Consumer credit ³⁾	13.0	7.8	8.2	8.2	8.5	8.0	7.9
Lending for house purchase ³⁾	70.7	11.1	11.8	12.1	11.3	10.4	10.2
Other lending	16.3	2.3	2.1	2.1	2.3	2.5	3.1
Insurance corporations and pension funds	1.0	29.3	32.9	41.2	36.8	29.0	26.1
Other non-monetary financial intermediaries	7.7	14.1	16.2	19.0	17.3	17.7	15.9

Source: ECB.

Notes: MFI sector including the Eurosystem; sectoral classification based on the ESA 95. For further details, see the relevant technical notes.

1) As at the end of the last month available. Sector loans as a percentage of total MFI loans to the private sector; maturity breakdown and breakdown by purpose as a percentage of MFI loans to the respective sector. Figures may not add up due to rounding.

2) As defined in the ESA 95.

3) The definitions of consumer credit and lending for house purchase are not fully consistent across the euro area.