



# Cost of negative interest rates to German households

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For many, the nominal interest rate is an easy indicator to grasp and they use it to make comparisons over time and across countries. However, inflation-adjusted rates are a more accurate indicator to identify the real returns and the impact of negative rates on household portfolios.

Cash and deposits account for 40% of Germans' financial assets. In Q1 2019, real returns on these stood at -1.2%. Claims on insurance schemes accounted for 37% of the total financial assets, with real returns of 1% in 2019, down from 3% in 2014.

Germans lost around EUR 150 in real terms in 2019 per person due to negative rates on their cash and deposits, compared to the 1991-2014 average. The aggregate loss including claims on insurance for a representative household was roughly EUR 540 per year. The perception that negative rates punish German savers is therefore not unfounded but actually not that unusual when looking at real rates. The richest 10% of Germans hold 60% of the financial wealth (although deposits and life insurances make up a smaller share of their portfolios) and probably have significantly higher losses.

## Bank lending and deposits of households in Q4 2019

In 2019, net lending to private households in Germany reached a new record of EUR 59.5 bn (+4.8% yoy). Mortgages saw a record increase of EUR 53 bn (5.3% yoy). In Q4, new mortgages of EUR 15.4 bn accounted for almost the entire credit growth. At EUR 6.8 bn (3.9% yoy) in 2019 as a whole, consumer lending lagged significantly behind the previous three years and slumped to EUR 46 m in Q4.

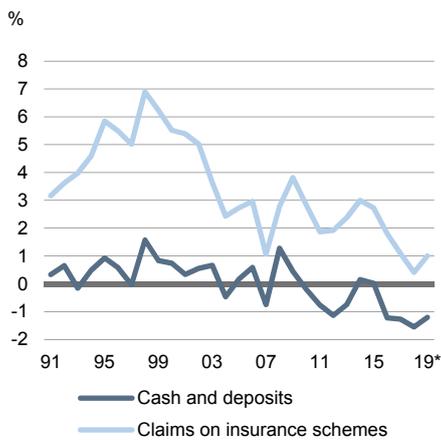
Deposits rose by EUR 41.1 bn in the seasonally strong final quarter. In the full year 2019, private households added a net amount of EUR 111 bn to their bank accounts, a bit more than in the previous years. However, the annual growth rate fell slightly to 5.0% on account of base effects.

In 2020, mortgage growth is likely to slump, even stagnate. The driving forces of excess demand and low interest rates should continue to support the market. But the corona virus pandemic causes significant uncertainty and will probably lead to a reduction in household income and possibly to bottlenecks in the issuance of building permits.



## Cost of negative interest rates to German households

Real returns on households' financial assets

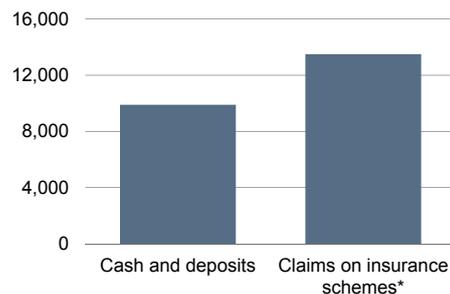


\*Q1 figures

Sources: Bundesbank, Deutsche Bank Research

Median values of financial asset holdings

EUR, for those who have such assets, 2014

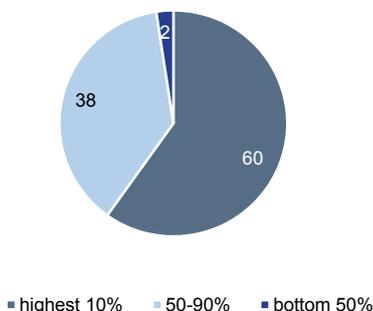


\*Private retirement provision and whole life insurance policies as well as Riester/Rürup retirement provision products

Sources: Bundesbank, Deutsche Bank Research

Richest 10% hold 60% of the financial wealth in Germany

% share of household wealth held by ... in 2014



Sources: Bundesbank, Deutsche Bank Research

The perception in Germany is that ECB measures, in particular sub-zero interest rates, are punishing German savers. Still, these measures seem to have failed at least with respect to German households, which increased their net saving rate to 10.5% in Q1 2019 from 9.4% in 2014. For many, the nominal interest rate is an easy indicator to grasp and they use it to make comparisons over time and across countries. However, comparing current rates with higher rates from the past ignores the impact of inflation. A more accurate indicator is real returns which are nominal rates minus inflation. These help identify the true effect of negative rates on household portfolios.

With EUR 2,314 bn in 2019, cash and deposits account for 40% of Germans' financial assets, a more or less stable share since 2014. In Q1 2019, real returns on these stood at -1.2% (see chart). Between 2014 and 2018, they were -0.7% on average. Since 2014 (and even before, during the sovereign crisis), German households effectively have been losing money on their cash and deposits. Yet negative real returns on deposits are not only a phenomenon of recent years. 1997, 2004 and 2007 all witnessed negative real interest rates because inflation was high. Between 1991 and 2007, German households earned a small positive real return of 0.4% on average on these savings. Cash and deposits make up only one part of the financial portfolio, though. Claims on insurance schemes accounted for 37% of the total financial assets in 2019 yet were held by a smaller circle of households. Real returns on this front stood at a meagre 1% in 2019, down from 3% in 2014. Between 1991 and 2013, claims on insurance schemes earned 3.8% on average. Taken together with cash and deposits, almost 80% of Germans' financial assets yielded negative or low returns in 2019.<sup>1</sup>

What are the absolute costs? Median cash holdings of Germans stood at EUR 1,100 and deposits at EUR 8,800 per capita in 2014 (latest date available).<sup>2</sup> Put differently, half of the Germans have more than EUR 9,900 in cash and deposits whereas the other half have less. By contrast, on average, households own EUR 33,700 in cash and deposits. The huge disparity between the median and the average points to significant inequality in financial asset holdings. Taking the median as reference, Germans lost around EUR 150 in real terms in 2019 per person due to negative rates on their cash and deposits, compared to the 1991-2014 average. Meanwhile, every other individual in Germany had claims on insurance firms. For those who possess some, the median value is EUR 13,500. The loss from these was around EUR 390 in 2019 per person. Taking cash and deposits plus claims on insurance into account and leaving aside other possible effects, the aggregate loss for a representative household is roughly EUR 540 per year. Obviously, this figure depends a lot on the reference group, i.e. wealthy households probably have significantly higher losses whereas those that do not possess insurance schemes lose less.

To identify who has been hit the hardest, it is important to look at the distribution of financial assets among households. Financial wealth is quite unevenly distributed in Germany. To be specific, the richest 10% of Germans hold 60% of the financial wealth. The 50-90% wealthiest or the famous middle class hold an in-line share of about 40%. The bottom 50% or half of Germans hold only 2%. Negative or low rates on deposits or insurance claims affect the rich much more than poorer individuals. That said, the wealthy are more likely to own other financial assets such as mutual funds or individual stocks. The potential gains from these need to be taken into account to determine the true return of more complex household portfolios.

<sup>1</sup> Other financial assets of households are mainly mutual funds and individual stock investments. These make up 16% of the total. Despite the relatively large share, only few households hold these assets, i.e. 13% own mutual funds and 10% own individual shares.

<sup>2</sup> Bundesbank (2016). Household wealth and finances in Germany: results of the 2014 survey. Monthly Report, March 2016, pp. 57-82.



## Cost of negative interest rates to German households

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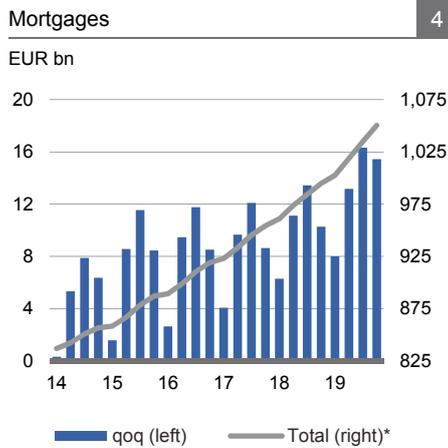
All in all, the perception that negative rates punish German savers is not unfounded but actually not that unusual when looking at real rates. Already in some years in the past, real returns were very small or even negative in Germany. The current episode of low real returns receives significant negative attention most probably due to its prolonged nature and most people's focus on nominal instead of real rates. Many also neglect the increase in the value of real assets such as real estate since 2014.

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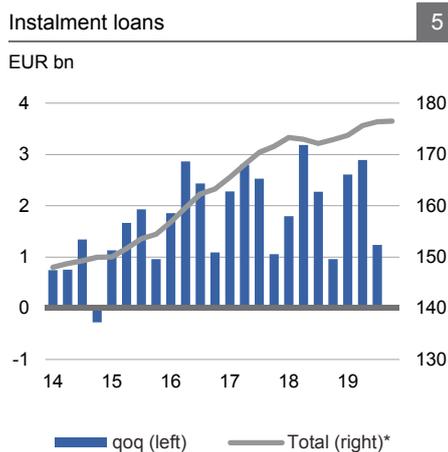
## Cost of negative interest rates to German households

### Bank lending and household deposits



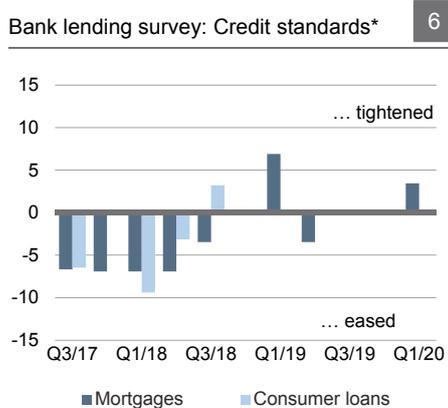
\*includes significant reclassification in Q3 18.

Source: Deutsche Bundesbank



\*includes significant reclassifications in Q2 & Q3 18.

Source: Deutsche Bundesbank



\*Q1/20 expected value

Source: Deutsche Bundesbank

#### Loan volumes

In 2019, net lending to private households in Germany reached a new record of EUR 59.5 bn (+4.8% yoy), exceeding the previous year's high by EUR 10 bn. The increase in Q4 (EUR 15.9 bn) was the strongest in an autumn quarter, though somewhat lower than in the previous quarter.

Mortgages constituted the main driver of this development, with a record annual rise of EUR 53 bn (5.3% yoy). In Q4, new mortgages of EUR 15.4 bn accounted for almost the entire credit growth. Savings banks (EUR +4.5 bn) and cooperative banks (EUR +4.2 bn) once again granted the most mortgages, followed by the large banks (EUR +3.5 bn) and building societies (EUR +2.1 bn). Private clients in Germany evidently still prefer to finance real estate through branch networks of traditional banks, despite a large online offering. The buoyant lending in 2019 reflected the strong demand and price increases in the housing market. Nevertheless, real estate remained affordable for many private individuals due to the extremely low interest rates and the benign economic situation. Household disposable income increased in 2019 both as a result of growing employment (+400,000 to 45.3 m) and higher wages.

In the **current year**, credit growth is likely to slump, even stagnate, due to the corona virus pandemic. The driving forces of excess demand and low interest rates should continue to support the market. But short-time working schemes and shrinking employment will probably lead to a reduction in household income. Also, there is extraordinary uncertainty which will presumably make households more reluctant to enter into new financial obligations, especially given the typically high amount of mortgages. Furthermore, the issuance of building permits may become a bottleneck, because employees of building authorities cannot perform all necessary tasks while working from home. In order to strengthen the supply side, BaFin has announced a reduction of the counter-cyclical capital buffer from 0.25% to zero, taking effect on April 1<sup>st</sup> and lasting at least until the end of the year. This is to ease lending through lower capital requirements. The capital buffer was only raised to 0.25% last year, mainly due to the increase in house prices and resulting credit risks. European banking supervisors have also adopted temporary capital relief measures for banks.

At EUR 6.8 bn (net) in 2019 (3.9% yoy), consumer lending lagged significantly behind the growth of the previous three years and slumped to EUR 46 m in Q4. The quarter also saw loan books shrinking not just at savings banks and cooperative banks (EUR -0.2 bn each), which are traditionally less active in this business, but also at large banks (EUR -70 m). Regional banks were the only banking group which significantly expanded its portfolio (EUR +0.8 bn). Surprisingly, foreign banks, which usually are a strong contender in the consumer loan business (statistically spread over regional banks and large banks as well as branches of foreign banks), recorded a significant decline. Debit balances (EUR -0.4 bn) and other loans (EUR +0.1 bn) remained almost unchanged in 2019.

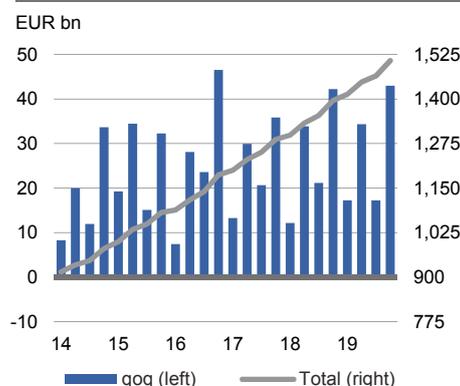
According to the Bank Lending Survey (BLS), 17% of banks registered rising demand for mortgages in Q4, which they attributed to the then still distinctly positive outlook on the real estate market and low interest rates. In contrast to the weak volume development, 6% of banks reported stronger demand for consumer loans. 17% (16%) of banks expect demand for mortgages (consumer loans) to rise in the current quarter.



## Cost of negative interest rates to German households

### Sight deposits

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Source: Deutsche Bundesbank

### Credit standards for approving loan applications

The banks did not change their credit standards for mortgages and consumer loans in Q4. For the current quarter, only 3% of banks expect a tightening, and only for mortgages. 7% (3%) of the banks reported an increased share of rejected applications for mortgage loans (consumer loans).

### Terms and conditions governing loan contracts

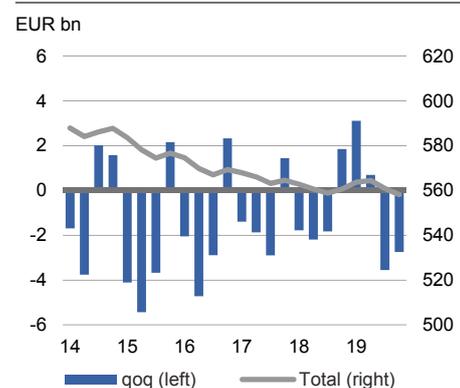
A small number of banks again expanded their mortgage margins in the last quarter of 2019. This was mainly true for riskier loans (reported by 7% of banks). All in all, 2019 was characterised by the end of the decline in mortgage margins which had been going on since 2012. Following a long time when competitive pressure prevailed, in 2019, internal supply criteria of many banks such as increased refinancing costs and balance sheet restrictions prevented margins from falling further. However, 10% (6%) of banks again recorded decreased margins on average (riskier) consumer loans.

### Deposit volumes

Germans traditionally boost their bank deposits the most at the end of the year – in the final quarter of 2019, by the substantial amount of EUR 41.1 bn. In 2019 as a whole, private households set aside EUR 111 bn, a bit more than in the previous years. Despite this, the annual growth rate declined slightly to 5.0% on account of base effects. In Q4, virtually all new savings flowed into sight deposits (EUR 43 bn), with the lion's share going to savings banks (EUR 16.5 bn), cooperative banks (EUR 13.5 bn) and large banks (EUR 7.6 bn). A small amount was added to time deposits (EUR 0.9 bn). The outflows of savings deposits (EUR -2.8 bn) came mainly at the expense of the savings banks and large banks, whereas the cooperative banks were able to acquire new business. Despite more banks starting to charge negative interest rates also for very large retail savings last year, the savings rate stayed virtually constant at 10.9% (2018: 11%). In light of the increase in disposable income, this was mainly due to the recovery in savings accumulation in the second half of the year, with the savings rate even reaching 11.2% in the final quarter.

### Savings deposits

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Source: Deutsche Bundesbank

### Interest rates

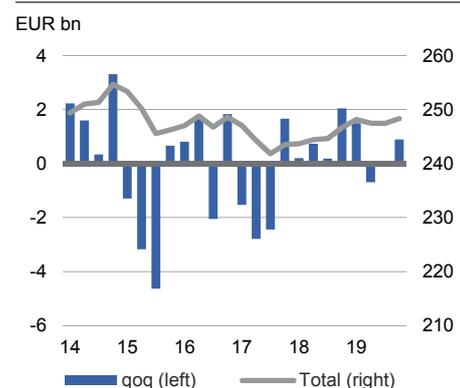
Sight deposit rates remained at a minimal 0.01% at year-end, where they have already stood since March 2019 (EMU average: 0.03%). In September, the ECB lowered the interest rate on the deposit facility to -0.5% and announced the resumption of securities purchases, with the EONIA subsequently falling to -0.46% in Q4. The average interest rate for new mortgages was flat in Q4 at a record low of 1.34%, and well below the EMU average of 1.75%. Consumer loan rates fell by 18 bp to 5.74% (EMU: 5.89%).

In light of the corona virus pandemic, the ECB announced a new asset purchase programme of EUR 750 bn (Pandemic Emergency Purchase Programme, PEPP). Thus, deposit rates are unlikely to rise anytime soon. Mortgage rates might even decline further in the short term.

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### Time deposits

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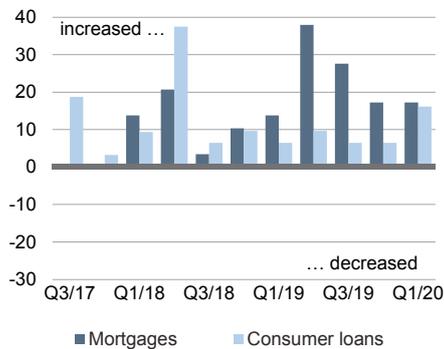


Source: Deutsche Bundesbank



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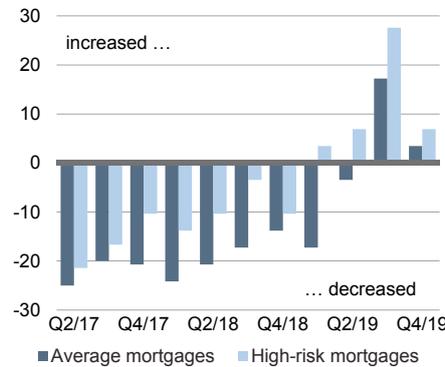
Bank lending survey: Credit demand\* 10



\*Q1/20 expected value

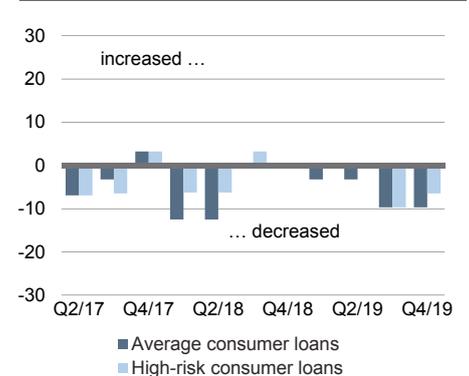
Source: Deutsche Bundesbank

Bank lending survey: Mortgage margins 11



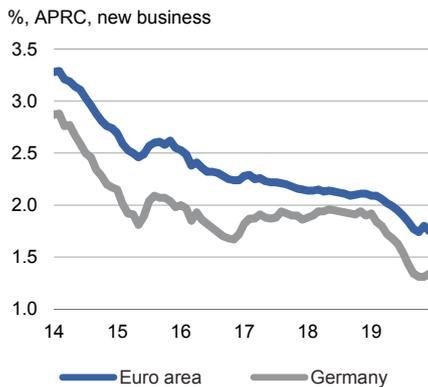
Source: Deutsche Bundesbank

Bank lending survey: Consumer credit margins 12



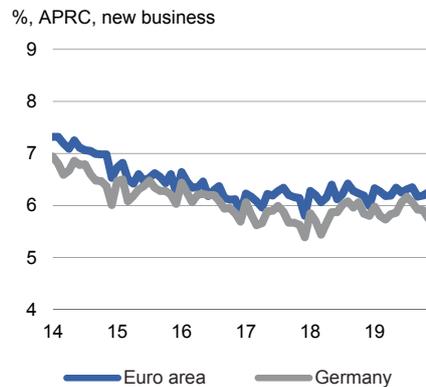
Source: Deutsche Bundesbank

Mortgage rates 13



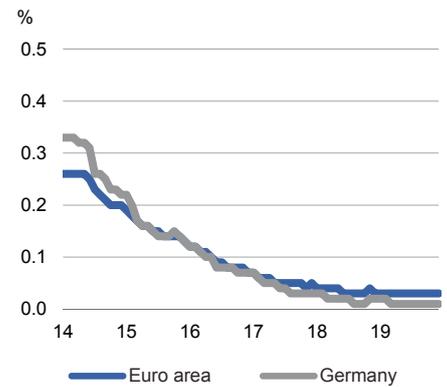
Source: ECB

Consumer credit rates 14



Source: ECB

Overnight deposit rates 15



Source: ECB

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