

ECB Money Market Contact Group

December 2020



TLTRO – Hypotheses for “recalibration”

At the ECB Forum on Central Banking (virtual Sintra) President Lagarde said that the PEPP and the TLTROs were likely to “remain the main tools for adjusting our monetary policy”. She has also expressed her belief in the importance of not just the *level* of financial conditions, but also the *duration* of policy support. With these matters in mind it is generally expected that at next week’s meeting the ECB is likely to announce changes and extensions to the TLTRO programme. Some market hypotheses we have seen from various research include:

- **Additional TLTRO operations.** The remaining ones are December and March, the programme should be extended with additional operations stretching through to at least end 2021.

Almost certain
- **Reduced rates.** This could be achieved by reducing either the headline rates or the discounted rate, or extending the period of discount. One potentially attractive option would be to announce an even better rate for a higher level of net lending, since most banks will already meet the existing target easily due to COVID drawdowns. This directly incentivizes additional, incremental lending.

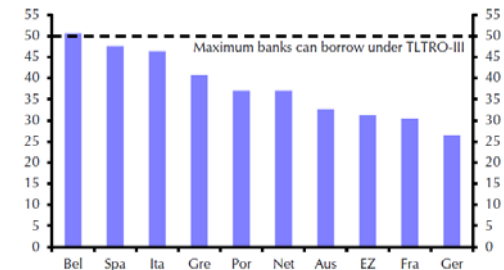
Very likely
- **Potential maturity extensions.** Could move from three to four year maturity on new subscriptions, while still retaining early repayment optionality. This might flatten the curve.

Likely
- **Increase the borrowing allowance** from 50% of eligible lending. This could increase the programme size with relatively limited negative consequences.

Likely
- **Collateral changes.** Could accepted broader collateral. But this has already been done, probably to the limit of appetite, and would not wish to inflate certain asset classes (notably mortgages). Could usefully encourage ACC adoption across jurisdictions. Temporary collateral rules to be extended or made permanent.

Not likely

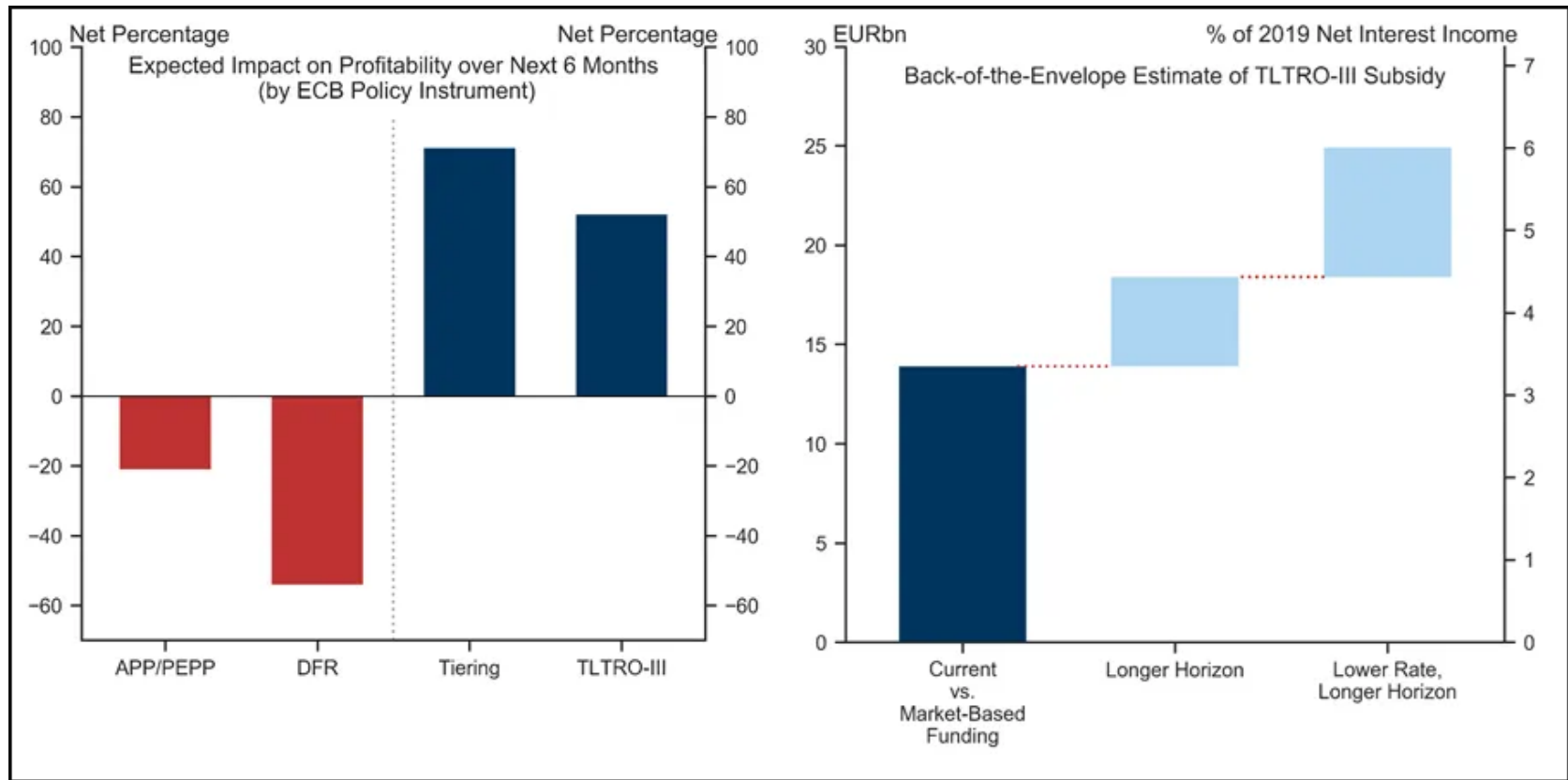
Total Borrowing Under LTROs & TLTROs
(% of Eligible Loans)



Sources: Refinitiv, ECB, Capital Economics

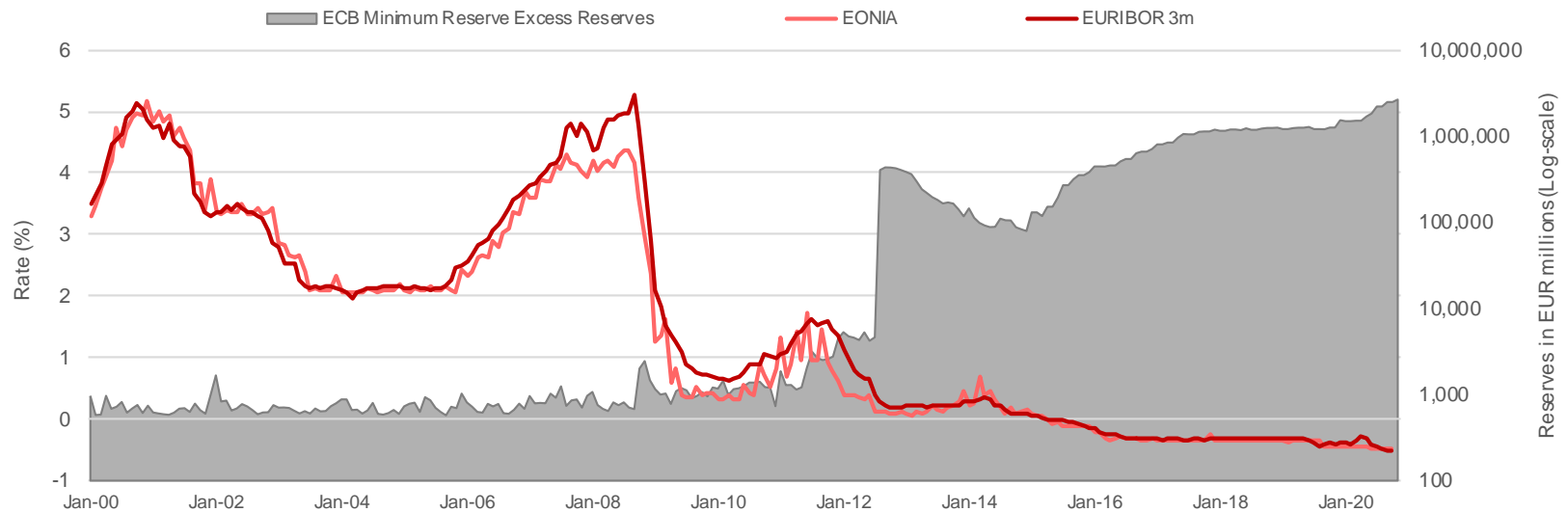
TLTRO – positive for lending volumes and bank profitability

There has been a positive impact from the ECB's policies on lending volumes and a dampening impact on lending rates. Bank profitability implications across instruments is contrasting, with asset purchases and the negative Deposit Facility Rate acting as a drag, and some offset coming from TLTRO-III and the two-tier reserve remuneration system.



Source: ECB's Euro Area Bank Lending Survey (BLS) October 2020, Goldman Sachs Global Investment Research

The relationship between excess reserves and short term rates

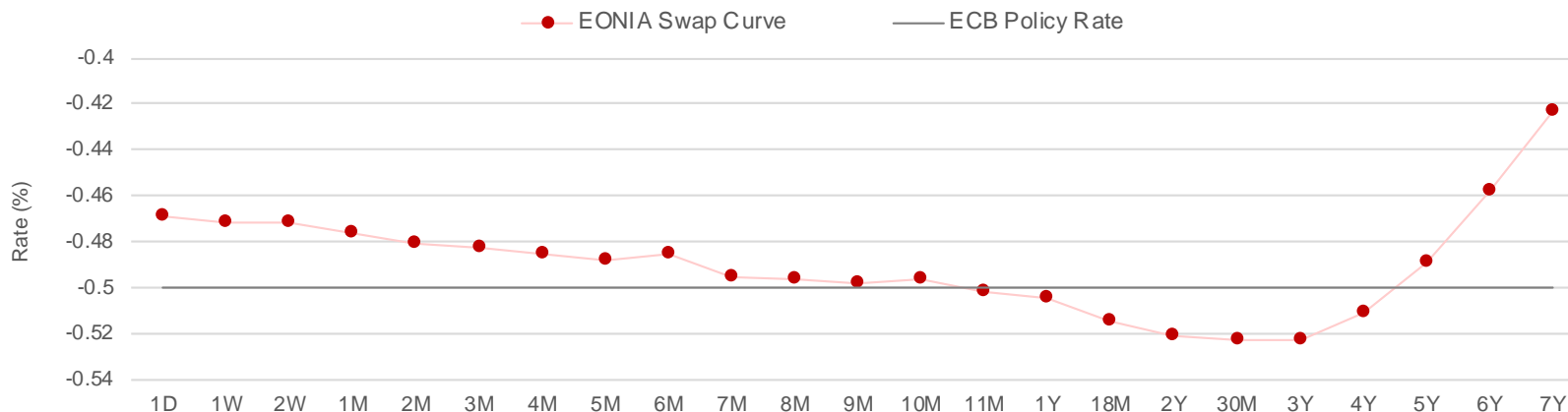


The graph above shows a clear link between increasing levels of excess reserves and decreasing short-term rates. But this could be disaggregated into two factors:

- 1) The link between policy rate cuts and policies which increase excess reserves. This is the main relationship which drives the above picture.
- 2) For any given level of policy rate, higher excess reserves appear linked to lower short-term rates. This link makes intuitive sense – more cash in the market trying to find a home should mean lower rates for that cash. Banks are also constrained by leverage ratios, meaning it is not “free” to intermediate cash through the to the central bank, so the Deposit Facility Rate doesn’t represent a floor.

The relationship between excess reserves and short term rates

It is likely that the link between excess reserves and short term rates could continue, albeit that excess reserves may grow less quickly.



The EONIA swap curve shows a fall in rates by roughly 6bps in the next 2 years. This may not be linked to rate cut expectations so much as to an expectation of continued deterioration of short-term cash rates relative to the ECB rate.