The review period saw the ECB continue to provide support to money markets by means of liquidity-providing operations with maturities of one week, one maintenance period and three months. All of these operations were conducted as fixed rate tender procedures with full allotment. Given the tensions in euro area financial markets, the Governing Council also decided to reduce the reserve ratio from 2% to 1% and to provide liquidity via two supplementary longer-term refinancing operations – also by means of fixed rate tender procedures with full allotment – with a maturity of approximately three years. The first of the two operations was conducted on 21 December, and the second was conducted on 29 February (see also Box 3 below).

Box 3

IMPACT OF THE TWO THREE-YEAR LONGER-TERM REFINANCING OPERATIONS

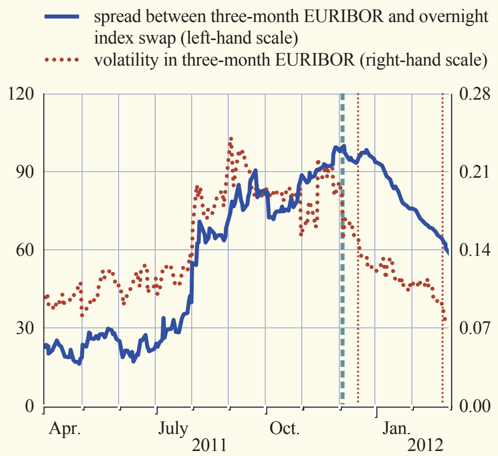
The intensification of the stress in sovereign debt markets in the second half of 2011 in the presence of high levels of uncertainty increasingly hampered euro area banks' access to market-based funding. Such impairment risked curtailing lending by credit institutions to euro area households and non-financial corporations. Chart A shows the increased tensions in euro area money markets as of July 2011, as reflected in higher levels of money market volatility and increases in credit risk premia.

To help to forestall such curtailment of credit and ensure that the ECB's monetary policy continues to be transmitted effectively to the real economy, and thereby safeguard price stability in the euro area, the Governing Council of the ECB decided on 8 December 2011 to implement additional non-standard monetary policy measures. The agreed package of measures included two longer-term refinancing operations (LTROs) with a maturity of three years and the option of early repayment.

The first such operation, which took place on 21 December 2011, provided €489.2 billion to 523 credit institutions. This included €45.7 billion transferred from the 12-month LTRO allotted in October 2011 and resulted in a net liquidity injection of €210.0 billion in that week. The second operation took place on 29 February 2012 and saw the allotment of €529.5 billion to 800 credit institutions, in addition to the €6.5 billion allotted in the regular three-month LTRO on that date. When the €29.5 billion allotted in the weekly main refinancing operation is also taken into account, the Eurosystem provided €565.5 billion in these three liquidity-providing operations. This should be seen in the context of the operations maturing in that week, which had a total value of €254.9 billion.

Chart A A euro area money market spread and volatility

(basis points; percentages)



Sources: ECB, Bloomberg and Thomson Reuters.
Notes: The vertical green line denotes the announcement on 8 December 2011 of the two three-year LTROs. The two vertical red lines mark the allotment of the two LTROs on 21 December 2011 and 29 February 2012 respectively.

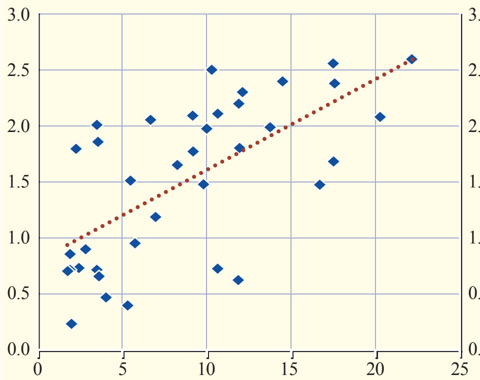
Analysis, combined with anecdotal information provided by banks, suggests that funding considerations played a major role in banks' bidding behaviour in the three-year LTROs.[1] Chart B shows a positive relationship between spreads on bank bonds at issuance (considering both secured and unsecured bonds) and the amounts bid by banks in both three-year LTROs as a percentage of their total assets. However, a substantial number of banks bidding in the three-year LTROs did not issue debt securities in 2011. The chart suggests that even if a bank had been able to obtain longer-term funds in the bond market, it could still have had a strong incentive to borrow from the Eurosystem owing to the lower cost involved. At the same time, these financing conditions render banks' investment and lending opportunities more attractive. This supports the Governing Council's view that these measures will help to remove impediments to the accessing of finance by the real economy.

By improving funding conditions for banks, the ECB may have avoided the disorderly shedding of assets, which would have placed certain financial market sectors under pressure. The three-year LTROs may also have helped to contain spillovers from the sovereign debt crisis to credit and broader financial markets. Moreover, they have improved market sentiment for a broad range of assets and helped to gradually reopen some previously closed market sectors. Chart C illustrates the general narrowing of credit risk premia in debt markets, as measured by spreads for credit default swaps (CDSs), after the LTROs. However, this also needs to be seen in the context of fiscal consolidation in the euro area and recent signs of economic stabilisation.

1 For analysis of the first operation, see Box 4, entitled "The impact of the first three-year longer-term refinancing operation", *Monthly Bulletin*, ECB, January 2012.

Chart B Banks' risk premia and bidding behaviour (for banks with market access in 2011)

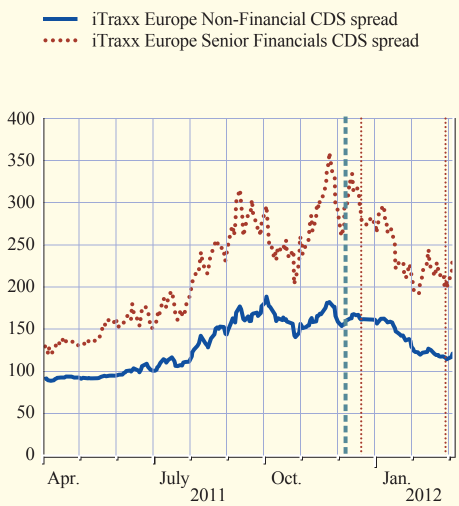
y-axis: spreads over mid-swap rates at issuance for long-term debt in 2011 in percentage points
x-axis: amounts bid in both three-year LTROs as a percentage of total assets



Sources: ECB, Fitch Ratings and DCM Dealogic.

Chart C Credit default swap spreads for financial and non-financial corporations

(basis points)



Sources: JP Morgan and ECB calculations.
Notes: The vertical green line denotes the announcement on 8 December 2011 of the two three-year LTROs. The two vertical red lines mark the allotment of the two LTROs on 21 December 2011 and 29 February 2012 respectively. The credit default swap spreads are on five-year on-the-run securities.

It may take several months for the full supportive impact on banks' lending to households and non-financial corporations to become visible in the monetary data. Thus, money and credit growth may remain subdued for some time, before strengthening as a result of these three-year LTROs (albeit recent data on money and credit growth also need to be seen in the context of the current subdued economic activity).

The ECB has at its disposal all of the means necessary to ensure that the conduct of its monetary policy leads to price stability in the euro area. Moreover, in order to manage the implications, in terms of risk, stemming from the corresponding expansion of its balance sheet, the Eurosystem continually reviews the eligibility of collateral and its risk control framework. Furthermore, the application of conservative risk control measures, such as haircuts, in all monetary policy operations ensures that the financial position of the Eurosystem remains sound.

The ECB also conducted weekly one-week liquidity-absorbing operations with a variable rate tender procedure and maximum bid rates of 1% in the twelfth maintenance period of 2011 and the first and second maintenance periods of 2012. With these liquidity-absorbing operations, the ECB offered to absorb an amount up to the value of the purchases made under the Securities Markets Programme, which totalled €217.8 billion on 7 March.

The review period was characterised by high levels of excess liquidity, with average daily recourse to the deposit facility over the three reserve maintenance periods in question (i.e. the twelfth maintenance period of 2011 and the first and second maintenance periods of 2012) standing at €462 billion. By comparison, average daily recourse to the deposit facility totalled €204 billion in the three previous maintenance periods (see also Box 4 below).

Box 4

LIQUIDITY CONDITIONS AND MONETARY POLICY OPERATIONS IN THE PERIOD FROM 9 NOVEMBER 2011 TO 14 FEBRUARY 2012

This box describes the ECB's open market operations during the reserve maintenance periods ending on 13 December 2011, 17 January 2012 and 14 February 2012. Throughout the period under review, all euro refinancing operations continued to be conducted by means of fixed rate tender procedures with full allotment.

On 8 December 2011 the Governing Council decided on additional enhanced credit support measures to support bank lending and liquidity in the euro area money market. In particular, it decided:

- to conduct two supplementary liquidity-providing longer-term refinancing operations with a maturity of approximately three years and the option of early repayment after one year – the first such operation was allotted on 21 December 2011 (replacing the 13-month longer-term refinancing operation that was scheduled to be allotted on that date and had been announced on 6 October 2011) and the second operation was allotted on 29 February 2012;