TLTRO-III assessment, expectations and its future.

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1. TLTRO-III modalities, critical changes.

**TLTRO-III.1-7**
- These can benefit from lower interest rate by exceeding thresholds in one or more of the 3 lending assessment criteria:
  - **Initial Criterion:** 1.15% from Apr’19-Mrch ’21
  - **Special Criterion:** 0% from Mrch’20 – Mrch’21
  - **Additional Special Criterion:** 0% from Oct’20 – Dec ’21

- Partly explains the high take up, March (nr.7) was the last possibility to have the benefit based on 3 lending criteria.

**TLTRO-III.8-10**
- These can only benefit from lower interest by exceeding the threshold of the additional special lending criterion.

- Previous criteria cannot be applied as they have expired at the time of participation.
2. March take-up surprised everyone.

**Take up TLTRO-III.7**

- March demand (EUR 330bn) was much higher than expected (EUR ~50-200bn).
- Critical changes support this.
- Banks expectations of a surge in loan demand when the economy reopens in combination of extension of lower interest rate from Jun ‘21 – Jun ‘22.
- Yet demand remains relatively limited so far.
- Many banks have closed in on their new benchmarks, but in some key countries gaps remain.

**Evolution of loans to corporates**
3. Two types of TLTRO-III users.

A. Funding/structural:
- Substitute for market-based funding.
- Included this ECB tool into their funding mix.
- Price insensitive (as long as it is comparable/better than market).
- Bulk seen in early-TLTRO-III’s.
- Likely to keep the funds beyond the discount periods.

B. Opportunistic:
- Using TLTRO-III as carry.
- Price sensitive, keeping the funds is a contingent on the discount (to a lesser extent developments in market rates, relative to base TLTRO-III rate).
- Bulk seen in TLTRO-III’s post-discount announce (4 and 7).
- Large III.7 take-up likely driven by expectations that benchmark will be met.
- Likely to repay (partially) after discount periods.
4. Expectations for TLTRO-III.8/9/10 operations.

**Benchmarks and discounts mostly relevant for the opportunistic group:**

- Banks replacing TLTRO for market based funding *(A. group)* assumed to be less sensitive for the extra discount, as base TLTRO-III rate already attractive for them relative to market rates.
- December ‘21 (III.10) may see a bulky allotment, only in gross terms as banks switch out of earlier TLTRO-III’s to extend funding by up to 2 years.
  - Banks can make a very good assessment in December of the eligible loans for the period oct-20 dec-21 which are applicable for the discount on III.10.
- This switch should give an indication of how sticky TLTRO-III is post-discount, *(B. group)* will likely be (partly) out.
- Upside risk to expectations:
  - Rising market-based rates on back of market enviroment.
5. TLTRO-III conclusions.

- Introduction is a success, reliance on the TLTRO-III is high.
  - Important to separate ‘funding’ from ‘opportunistic’ motive.
- Meeting lending benchmark.
  - European wide competition leads to:
    - Lower margin/higher (credit) risk acceptance.
- Reduced reliance of bank issuance as TLTRO-III becomes part of the funding mix.
  - Creates markets anomalies:
    - (money market) investors forced to look at alternative investment opportunities.
    - EURIBOR methodology, level 3 contribution high.
    - Certain (longer, >10yrs) tenors are targeted when banks issue.
- Dependency imposes cliff risk.
  - Concentrated substitution TLTRO-III funds with market-based funding on large scale could result in higher funding costs.
6. For discussion: TLTRO-IV

A. Funding/structural:
- Longer-term operations to remain a regular ECB instrument from banks perspective, in order to avoid/manage liquidity cliff effects?
  - Long, flexible maturity to allow a long-term backstop, while banks can switch to market-based at opportune moments.
  - Discount-scheme will either disappear, or first make way for a new incentive post-pandemic?

B. Opportunistic:
- Opportunistic TLTRO users will be disincentivised when DFR and hard to reprice retail deposits return to normal levels.
  - Supervisory angle: not extending leverage ratio exemption for CB deposits, will push out the banks that have constraints in this metric?
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