

Box 3

REVISITING THE IMPACT OF ASSET TRANSFERS TO “BAD BANKS” ON MFI CREDIT TO THE EURO AREA PRIVATE SECTOR

The financial crisis has prompted some euro area countries to establish “bad bank” schemes in order to enable credit institutions to remove from their balance sheets assets that are at risk of severe impairment or are difficult to value. An earlier Monthly Bulletin box published in anticipation of the implementation of these schemes provided a stylised description of the expected implications for MFI balance sheet statistics.¹ Since then, sizeable transfers to three schemes have taken place, involving portfolios of both loans and securities, and recipient entities that do not belong to the MFI sector. This box summarises the main effects of the transfers, focusing on credit to the euro area private sector.²

1 See the box entitled “The impact of ‘bad banks’ on MFI balance sheet statistics”, *Monthly Bulletin*, ECB, March 2010.

2 For the purposes of this box, the “euro area private sector” comprises all resident sectors with the exception of the MFI and general government sectors, while “credit” comprises financing provided to these sectors in the form of either loans or debt securities.

The importance of a careful analysis of MFI credit to the private sector

The focus on MFI credit to the private sector stems from the fact that developments in bank lending make a significant contribution to the assessment of the nature of monetary expansion. The analysis of MFI credit growth also offers insight into the operation of the monetary policy transmission mechanism and financing conditions in the economy. As a result, such analysis has been of particular importance from a monetary policy perspective during the financial crisis.

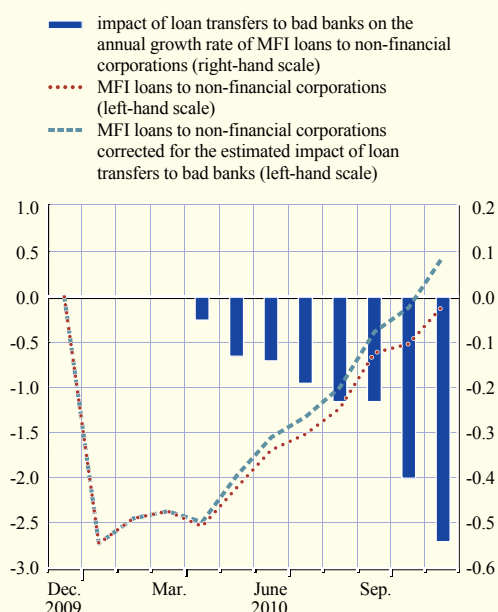
In this context, it is important to identify changes in the growth of MFI credit to the private sector that reflect pure asset/liability management transactions on the part of specific MFIs. Such transactions are, on the whole, unrelated to the actual flow of credit being made available to the private sector, with the most prominent example being the true-sale securitisation of loan portfolios.³ The Eurosystem's statistical framework allows the effect that true-sale securitisation and other loan sales have on the growth of MFI loans to be quantified, and a statistical series adjusted for these effects is published on a regular basis.⁴ Since transfers of loan portfolios to bad banks are a type of loan sale, their impact is removed from the headline data published for MFI loans in the series "adjusted for sales and securitisation". However, given the specific, non-recurring nature of these transfers, the following section discusses the impact that transfers to bad banks have had on MFI loans to non-financial corporations, the main category of loan affected by the current schemes.⁵

The impact of asset transfers to bad banks on MFI loans to non-financial corporations

The transfer of loans from MFI portfolios to bad banks is estimated to have reduced the annual growth rate of MFI loans to euro area non-financial corporations by approximately 0.5 percentage point as at end-November 2010

Chart A The impact of transfers to bad banks on MFI loans to non-financial corporations

(annual percentage changes; percentage points)



Sources: ECB and ECB estimates.

3 Strictly speaking, this requires that the securitisation give rise to the derecognition of these loans from the originating MFI's balance sheet, which may not always be the case. For more information, see the box entitled "The impact of MFI loan securitisation on monetary analysis in the euro area", *Monthly Bulletin*, ECB, September 2005, and the box entitled "The importance of accounting standards for interpreting MFI loan statistics", *Monthly Bulletin*, ECB, March 2008.

4 See the box entitled "Publication of data on MFI loans to the private sector adjusted for sales and securitisation", *Monthly Bulletin*, ECB, February 2009. More recently, a breakdown distinguishing between the effect of loan sales and securitisation for loans to households and the effect for loans to non-financial corporations has been made available through the ECB's Statistical Data Warehouse (<http://sdw.ecb.europa.eu/>).

5 In 2010 the implementation of three bad bank schemes had an impact on the consolidated and aggregated balance sheet of the euro area MFI sector. Two of these schemes were established under the German Financial Market Stabilisation Act of 2008, with a third scheme established under the Irish National Asset Management Agency (NAMA) Act of 2009. Detailed information on the German schemes is available at www.soffin.de, and details of the Irish scheme can be found at www.nama.ie

(see Chart A).⁶ This is somewhat less than the maximum impact of 0.75 percentage point expected in the earlier box on the basis of information available on euro area bad bank schemes in early 2010. The difference mainly reflects the fact that the implementation of the transfers started later than initially envisaged. However, given that further loan transfers have been announced but not conducted as at end-November 2010, it is expected that the estimated peak effect will eventually be broadly confirmed.

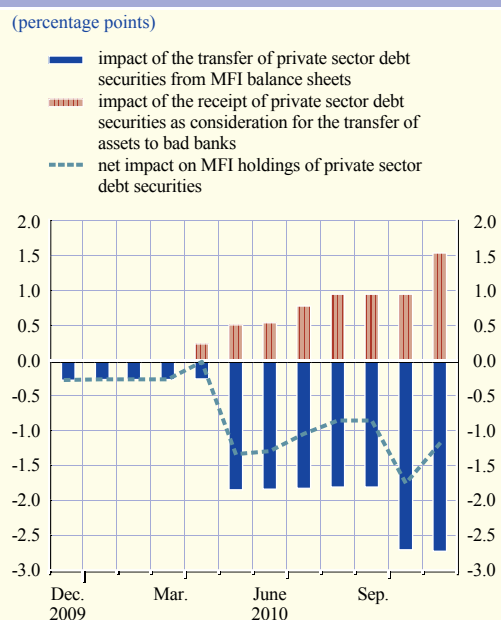
As can be seen in Chart A, a turning point in the annual growth rate of MFI loans to the non-financial corporation sector can be identified in early 2010 irrespective of whether allowance is made for the effect of transfers to bad banks. At the same time, the strength of the gradual recovery in MFI lending to this sector is somewhat underestimated by the unadjusted data, with the result that positive growth can, as at end-November 2010, be observed only in the adjusted series.

The impact on MFI holdings of debt securities issued by the euro area private sector

Asset transfers to bad banks have also had a significant effect on MFI holdings of debt securities issued by the euro area private sector, which represent the second-largest component of MFI credit to this sector. The securities transferred have primarily been issued by non-monetary financial intermediaries other than insurance corporations and pension funds (OFIs) and have consisted mainly of structured finance securities such as asset-backed securities and collateralised debt obligations. Transfers of debt securities issued by euro area non-financial corporations have been significantly smaller. The transfer of private sector debt securities to bad banks has substantially reduced the annual growth rate of the associated MFI statistical series, with the impact as at end-November 2010 estimated at approximately 2.75 percentage points (see Chart B).⁷

A further impact stems from the fact that, in one particular scheme, the consideration received by the transferring banks in exchange for the loans eligible for the scheme takes the form of debt securities issued by the purchasing bad bank. Since in that scheme the bad bank entity is, for statistical purposes, classified as part of

Chart B The impact of transfers to bad banks on the annual growth rate of MFI holdings of euro area private sector debt securities



Source: ECB estimates.

⁶ The transfers have had a larger impact on the amount of outstanding MFI loans to non-financial corporations. This is due to the fact that most of the loans transferred were written down substantially prior to their transfer. As write-downs are not considered to be financial transactions in a statistical sense, they do not affect the annual growth rates, since growth rates are calculated excluding the effects of non-transaction-related changes in outstanding amounts of loans. However, write-downs do reduce the stock of outstanding loans on MFI balance sheets.

⁷ Unlike loans to the private sector, a statistical series for MFI holdings of private sector debt securities adjusted for sales and securitisation is not regularly published by the ECB, given the inherently tradable nature of these assets.

the OFI sector, which is part of the private sector, MFI holdings of private sector debt securities have increased as a result of the transfers.⁸ When taking this countervailing effect into account, the net impact on the annual growth rate of MFI holdings of private sector debt securities as at end-November 2010 is reduced to approximately 1.25 percentage points (see Chart B). Adding this net impact to the statistically recorded series would mean that the annual growth rate of such holdings had consistently been significantly positive since mid-2010. However, as in the case of MFI loans to non-financial corporations, making this adjustment would not alter the direction of developments in the annual growth rate or the timing of the turning point.

While this box looks only at the impact that asset transfers to bad banks have had on MFI credit to the euro area private sector, it should be noted that these transactions have also had a substantial impact on other items in the MFI statistical balance sheet. For instance, many of the assets transferred have consisted of claims (in the form of both loans and holdings of debt securities) vis-à-vis entities not resident in the euro area. This has had a significant dampening effect on euro area MFIs' holdings of external assets. Furthermore, some of the assets transferred have been claims on the euro area general government sector. However, an even larger share of the consideration received has taken the form of better-rated claims on the same sector, mostly in the form of debt securities issued by the bad banks purchasing the assets, thereby resulting in an overall net increase in MFI credit to general government. In addition, some of the transactions with bad banks have had implications for MFI balance sheets that span several euro area countries and have an impact on the aggregated MFI balance sheets of more than one euro area country.⁹ This underlines the importance of considering the euro area as a whole when examining the effects of asset transfers to bad banks.

Conclusions

The detailed analysis of developments in MFI credit to the euro area private sector is a key part of a broad-based monetary analysis. This box shows that asset transfers to bad banks have had a significant impact on two of the main components of MFI credit to the private sector – namely loans to non-financial corporations and holdings of private sector debt securities – but do not alter the broad assessment of credit dynamics made on the basis of the unadjusted data. Looking ahead, the relatively small volume of transfers envisaged under existing bad bank schemes which had still not been completed by the end of November 2010 implies a moderate further effect on MFI balance sheets in the coming months.

⁸ In the remaining cases, the bad bank entity is classified as part of the general government sector.

⁹ For statistics on national aggregated MFI balance sheets, see the "Statistics" section of the ECB's website (<http://www.ecb.europa.eu>).