Box 1

THE TARGETED LONGER-TERM REFINANCING OPERATION OF SEPTEMBER 2014

On 5 June 2014 the Governing Council decided to conduct a series of targeted longer-term refinancing operations (TLTROs) between September 2014 and June 2016, with the intention of supporting lending to the non-financial private sector and thereby enhancing monetary policy transmission. These operations are part of a broader monetary policy package that has included further cuts in key ECB interest rates and the announcement of an asset-backed securities purchase programme as well as a new, third covered bond purchase programme. The measures are aimed at reinforcing the accommodative monetary policy stance in view of the persistently weak inflation outlook, slowing growth momentum and subdued monetary and credit dynamics. This box discusses the outcome of the first TLTRO of September 2014.

In the context of the TLTROs, counterparties are entitled to an initial borrowing allowance equal to 7% of the total amount of their loans to the euro area non-financial private sector as of 30 April 2014, excluding loans to households for house purchase. Counterparties have the option of drawing on their initial allowance in the first two operations of September and December 2014.[1] The TLTRO of 18 September therefore has to be seen in conjunction with the operation that will be allotted on 10 December.

Given the common base of the TLTROs in September and December, banks may prefer one operation over the other for reasons unrelated to the overall attractiveness of the TLTROs. For example, banks' funding structures and refinancing obligations may make it more attractive for them to participate in December rather than in September. Moreover, many banks are currently in the process of finalising their planning for the year ahead, rendering the December operation more appealing for them, as they would then be in a better position to determine their demand for TLTRO funds, also taking into account further repayments of the three-year LTROs. Finally, participating in the December TLTRO would allow significant banks to take the results of the ECB's comprehensive assessment into consideration.

Eligible counterparties could choose to participate either on an individual basis or as part of a "TLTRO group" through a "lead institution", which conforms to Eurosystem eligibility criteria. Group formation allows banks to deploy the balance sheet of the whole group in order to borrow centrally and then redistribute liquidity through internal capital markets. Furthermore, it enhances risk diversification in the presence of weak credit demand among group members, while minimising the operational cost per participating bank as a result of economies of scale.

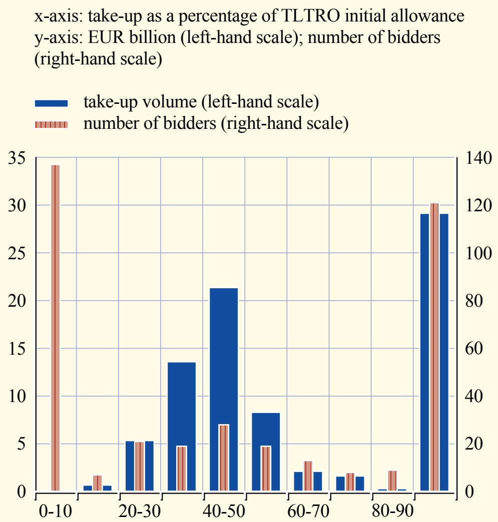
A total of 63 groups encompassing 1,244 institutions were given approval to participate in the TLTROs. They comprise 27 cross-border groups, representing 233 institutions, and 36 domestic groups with a total of 1,011 institutions. For the first TLTRO in September, 53 groups submitted reporting templates, while ten decided not to do so yet. Of the former, 37 groups comprising 520 institutions bid for a total amount of €41.8 billion in the first TLTRO, representing 41% of their initial allowance. The remaining 218 bidders were individual banks. Additional counterparties that intend to participate in the second TLTRO will have to submit their reporting templates by 20 November 2014.

Overall, a total of €82.6 billion was allotted to 255 bidders representing 738 credit institutions in the first TLTRO. On the basis of the balance sheet data submitted by the banks up to 28 August, this amounts to 40% of the initial allowance of €206.7 billion. Participation was broadly based

1 Additional liquidity will be provided in a series of follow-up TLTROs conducted on a quarterly basis between March 2015 and June 2016. These additional amounts can cumulatively reach up to three times their net lending to the euro area non-financial private sector, excluding loans to households for house purchase, between 30 April 2014 and the respective allotment reference date in excess of a benchmark. The maturity of all TLTRO loans is set for September 2018, with banks able to opt for early repayment as of 24 months after each TLTRO. The respective interest rate of the TLTRO loans will be fixed over the life of each operation at the prevailing rate for the Eurosystem's main refinancing operations (MROs) at the time of take-up, plus a fixed spread of 10 basis points. For further details, see http://www.ecb.europa.eu/press/pr/date/2014/html/pr140703_2.en.html and http://www.ecb.europa.eu/press/pr/date/2014/html/pr140729.en.html.

across the euro area. The average amount bid for was €324 million, while the median amount was €30 million, reflecting the skewed density of bank sizes. A large number of bidders (121) exhausted their initial allowance in the first TLTRO (see chart). On average, these bidders were entitled to relatively low initial allowances. They accounted for 35% of the total amount borrowed. By contrast, bidders accounting for 50% of the total amount allotted in the first TLTRO used no more than half their initial allowance. Eligible counterparties which have not reached their initial allowance in the first TLTRO will actually be able to increase their initial borrowing amount up to that limit in the second TLTRO.

Utilisation of initial allowance in the first TLTRO



Source: ECB.
Note: The chart refers to the counterparties that submitted reporting templates for the TLTROs by 28 August 2014 and were therefore eligible for participation in the first TLTRO.

The impact of the first TLTRO allotment of €82.6 billion on liquidity depends on changes in other Eurosystem credit operations settled during the same week because banks may be substituting these operations for the TLTRO. Repayments on the three-year LTROs that were settled on the same day as the first TLTRO amounted to €19.9 billion. The MRO that was settled on the same day as the first TLTRO saw a decline of €15 billion compared with the maturing MRO, while the overall size of the three-month LTRO that was settled the same week did not change. Overall, following the settlement of all operations, €47.9 billion of liquidity was injected in net terms, compared with an allotment result of €82.6 billion. Excess liquidity increased by €44.5 billion, to €121.9 billion on the settlement day of the first TLTRO.

A full analysis of banks' bids in the TLTROs in comparison with their initial allowances will only be possible after the second TLTRO in December, as banks' demand for these operations will then have been revealed more fully. Nevertheless, initial indications of their motives can be seen from their borrowing in September. Counterparties seem to have bid in the September TLTRO because of its attractiveness compared with market sources of funding with comparable maturities of four years. In particular, those that had both larger amounts of long-term bonds maturing before the next TLTRO and less favourable market funding costs tended to borrow larger amounts in the first TLTRO. Counterparties' current bids therefore largely reflect their cost/return considerations.

The incentives embedded in the TLTRO measure should stimulate the supply of credit by banks that submitted bids, and by the banking system in general. However, it is not yet possible to assess the extent to which borrowing in the first TLTRO is being translated into increased net lending to the economy. Nevertheless, the reduction in lenders' funding costs achieved through this first operation should be passed on to their borrowers and is thus likely to result in easier financing conditions for the private sector. Analysis of the lending behaviour of individual bidders' over the coming months will provide useful information in this regard.