

# The ECB's QE2. How To Read The LTR0

The 22 Feb MR0 allocation came in at 166 billion EUR, 23 billion EUR more than the 15 Feb MR0 of 143 billion EUR. All is not lost for those expecting another outsized allocation for the upcoming 3 year LTR0 on 29 Feb. But interpreting a small or large number is not straightforward.

The size of the 3 year LTR0 will not be known or estimable until the eleventh hour, literally the day before. In the 22 Dec 3 year LTR0, 292 billion of MR0 stood ready to rollover into the LTR0, then, a day before, a further 142 billion was allocated for the overnight repo. The next day, a full 489 billion EUR was allocated.

We will have to wait till a day or two before the settlement date to gauge the size of the 29 Feb LTR0. The implications will be interesting to say the least.

The first 3 year repo took away the stress in the banking industry and the LIBOR market, leading to a sharp relief rally in European bank stocks and risk assets in general. It was a relief rally in the true sense of the word since there was no direct link between the money thus created and the risk assets that rallied. What can we expect of the upcoming LTR0.

The market expects a big number, several surveys indicate an allocation circa 600 billion EUR. Anecdotal and ad hoc guesstimates offered by soothsayers and witchdoctors have ranged as far as 1 to 2 trillion EUR. We may yet get a large number, but we are certainly not seeing the momentum in the MR0 rollovers to expect a particularly big number. The proceeds of the previous loans stew in ECB cash deposits

earning 0.25% while the loans themselves cost 1%. Its not very good business. So far this warchest has only been deployed in peripheral Europe's sovereign bond auctions, surely a case of doubling down into a precarious carry trade. The German banks have eschewed borrowing at the LTRO arguing that they do not need to (although some of them actually do) and that the stigma of doing so might actually hurt their karma.

A big allocation at the next 3 year repo may actually be a bad thing. But I would still expect the reaction to be positive for stocks as traders routinely misinterpret the facts. More morphine does not a healthy patient indicate. Besides, how would the loans be deployed. Demand for credit is slow, Basel 3 is unfriendly, buying more sovereign bonds only ties the banks more closely to their sovereigns, and leaving it at the ECB for pure liquidity reason is uneconomic. Yet one can safely bet that a big number will likely lift bank stocks and indeed the Euro, a clear loser in this stratagem of debt monetization by stealth.

What about a small number? This would be a sign of strength, that the first LTRO was successful and that no further large scale money printing was necessary. Unfortunately, it is necessary. Yet we may not get the large number we seek. If the banks believe that the 3 year repo has become recurrent and routine, it may not need to hoard liquidity. As always, it pays to bet on a behavioral basis. Myriad recreational traders will likely sell the market if the LTRO is small. And the Euro is likely to fall.

I may not get my predictions about the markets right, but I would always bet on my understanding of human behaviour. This is how we are.