

ECB LTRO. QE Lite But More Effective. Is European Demand For Credit Bottoming?

In December 2011 the ECB embarked on its first 3 year LTRO, or long term refinancing operations. This is basically a secured credit line available to banks posting eligible collateral. LTRO 1 was a great success raising 489 billion EUR which the banks used to purchase sovereign bonds and unwind inter Euro area current account imbalances. LTRO 2 was 529 billion EUR. These initial LTROs were unconditional except for collateral quality. The proceeds were used in the end to buy zero risk weighted assets, sovereigns, and helped Euro area governments to refinance at a time when the bonds markets threatened to close to them. At the same time it allowed banks to borrow cheaply and buy higher yielding assets that consumed little to no capital.

The later TLTROs carried conditions, namely that the banks would be limited to borrowing up to a proportion of their loans to the private sector. The purpose of these conditions was to spur private sector lending. Take up of TLTROs has been slow because for one, the capital consumption of private sector loans is high and so the cost of lending is less impacted by the cheap financing afforded by the TLTROs, and two, private sector demand for credit has been weak.

When the ECB announced QE in early 2016, it also initiated TLTRO II, similar to TLTRO I but with cheaper financing rates, again subject to conditions. Now take up has been very strong, 399 billion at the first auction on June 24. If the high take up is a sign that bank lending is about to accelerate and that demand for credit is rebounding, this would be good news for the Eurozone economy. There are reasons for caution. The TLTRO II auction was opened June 23, the day of the UK EU

Referendum. It is very possible that the large take up of LTRO II.1 was simply a risk management reaction to a highly uncertain situation and banks wanted to raise as much liquidity they could.

We are seeing an easing of lending standards and some pick-up in demand for credit from households and businesses but it remains to be seen if this can be sustained. We are a long way from a general releveraging of the economy, which might tilt the balance in favour of equity from debt.