# The ECB is Ready For QE

For the first time in its history the ECB is extending 3 year collateralized funding at 1% to European banks.

The take up for shorter term funding in this time of money market stress has been strong with some 197 banks borrowing 292 billion EUR over one week. The one month tender declined as the 3 year tender opens December 21. Forecasts for the take up of the 3 year tender range from 20 billion to 250 billion EUR. The take up is likely to be at the top end of forecasts or exceed it.

- Banks need stable funding. The 3 year tender provides them 3 year money with a 12 month break.
- Sovereigns need a backstop buyer for their bonds. European banks will be vessels of the ECB as it assumes the role of lender of last resort.
- Some sovereigns are still AAA or AA and carry a zero risk weight under Basel III. Banks are thus able to fund themselves at the ECB refi rate of 1% and lend at 1.5% to 3% to France, or at 5% to Italy or Spain.
- Banks are likely to purchase their own country's debt instead of other countries' debt. This is to mitigate the risk of a disintegration of the Euro. This will also reduce the intra Euro area cross border holdings of sovereign debt which will make a potential break up of the Euro less damaging. A cynic might suspect the ECB of envisaging and encouraging such an eventuality.
- The ECB will be able under this mechanism to operate debt monetization without explicitly buying sovereign debt. This will circumvent any legal or treaty issues which have confounded previous plans.
- Additionally this has the effect of recapitalizing the European banking system without equity dilution. Retained earnings count as capital.

And thus debt which was once transferred and transformed from private to government balance sheets may be transferred once again to private balance sheets with a little help from the ECB.