

THE EURO AREA GOVERNMENT DEBT SECURITIES LENDING MARKET

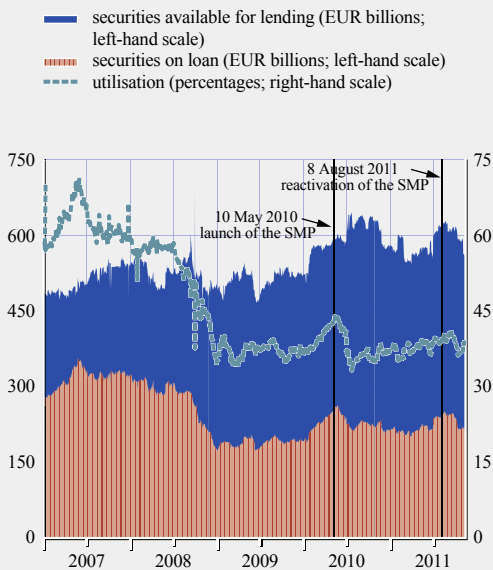
Owing to the lack of publicly available quantitative information, relatively little is known about the euro area government debt securities lending market. The same holds true, albeit to a much lesser extent, for securities lending in general. This is more relevant and cause for concern in view of the fact that securities lending represents an important part of the global shadow banking system. Against this background, the purpose of this box is to introduce securities lending activity and to provide some information on the euro area government debt securities lending market, with an additional focus on three euro area countries covered by EU/IMF financial support programmes.

Securities lending involves a temporary transfer of securities to a borrower, who will usually have to provide the lender with collateral in the form of cash or other securities.¹ Although securities loans that are collateralised against cash are economically equivalent to repurchase agreements (repos), they are usually motivated by a demand to borrow a security, rather than to lend cash.

¹ In the United States, securities loans are collateralised predominantly by cash, whereas in Europe securities, such as bonds or equities, are reportedly more common.

Chart A Euro area government debt securities lending market

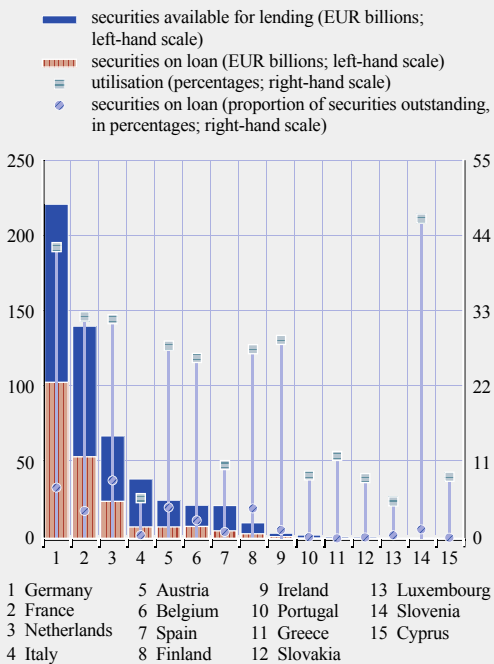
(Jan. 2007 – Nov. 2011)



Sources: Data Explorers and ECB calculations.
 Notes: Utilisation is the ratio of borrowed securities to securities that were made available for lending. Securities on loan also include securities borrowed from sources other than those captured in the value of securities available for lending. In addition to changes in the quantity of securities, the value of lendable and borrowed securities is affected by changes in the price of those securities. "SMP" stands for the ECB's Securities Markets Programme.

Chart B Euro area government debt securities lending market by sovereign issuer

(as of 16 Nov. 2011)



Sources: Data Explorers, ECB and ECB calculations.
 Notes: See notes to Chart A. Sovereign debt securities outstanding refer to the nominal value of such securities at the end of 2010. There was no information on the lending of Estonian and Maltese government debt securities.

Securities lending is very important for a smooth functioning of markets, since it facilitates, among other things, trade settlement, market-making and short-selling. In so doing, it can improve market liquidity. Moreover, it expands funding options. In a collateral upgrade or swap trade, less liquid and lower-quality securities are swapped for more liquid and higher-quality securities that can subsequently be used as collateral in the repo market or at a central bank. The benefits of securities lending, however, do not come without risks to financial stability, as these transactions increase interconnectedness amid limited transparency in the securities lending market.² In addition, the market is vulnerable to the pro-cyclicality of margining practices.³

According to Data Explorers, a securities lending data provider, at least €1.4 trillion of securities were on loan across the globe in mid-November 2011, which is more than 15% of at least €8.8 trillion of lendable securities, i.e. securities that were made available for lending. The market is continuing to grow, but has not yet again reached pre-crisis heights.

2 See Bank of England, "Developments in the global securities lending market", *Quarterly Bulletin*, third quarter, 2011.
 3 See Committee on the Global Financial System, "The role of margin requirements and haircuts in pro-cyclicality", *CGFS Papers*, No 36, March 2010.

The value of lendable and borrowed euro area government debt securities was at least €561 and €218 billion respectively, or around 9.1% and 3.5% respectively, of all euro area government debt securities outstanding at the end of 2010 (see Charts A and B). Larger euro area sovereign debt markets tended to have larger amounts of securities on loan, as well as higher utilisation, i.e. a higher ratio of borrowed to lendable securities (see Chart B).

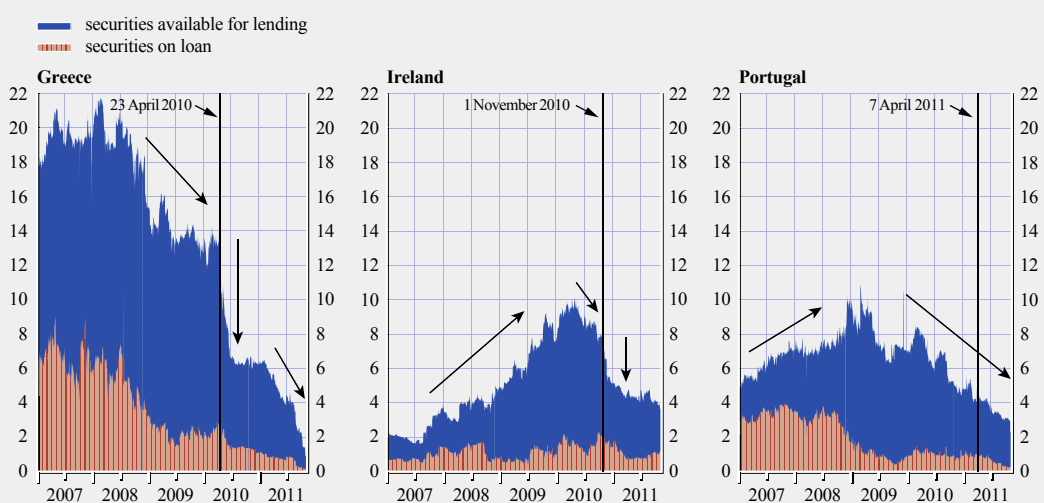
It would be misleading to attribute all government debt securities on loan to directional short-selling, since such securities are used extensively for repo transactions and collateral swaps (upgrades), as well as for arbitraging, hedging and relative value trading. Nevertheless, the increases in government debt securities on loan before the adoption of key crisis-related policy measures could be viewed as suggestive of higher short-selling activity before those dates (see Charts A and C).

By contrast, the interpretation of changes in lendable securities is more straightforward, as they should reflect fluctuations in the institutional ownership of those securities. Thus, a decrease in securities available for loan would, ceteris paribus, indicate that institutional securities lenders are withdrawing their securities from the lending market, most likely because they plan to sell them. It is important to note, however, that changes in the value of lendable and borrowed securities could be also be due to changes in the market price, rather than to the quantity of securities.

Bearing this important caveat in mind, it is nonetheless noteworthy that developments in the government debt securities lending markets of three euro area sovereign issuers with EU/IMF financial support programmes had certain supply and demand patterns in common (see Chart C). First, the value of government debt securities available for lending had started to decline well before the dates on which the respective countries requested EU/IMF financial assistance. Second, shortly before the aforementioned dates, securities borrowing had also increased in the case of Greece and Ireland, probably on account of higher short-selling as prices of debt

Chart C Developments in the Greek, Irish and Portuguese government securities lending markets

(Jan. 2007 – Nov. 2011; EUR billions)



Source: Data Explorers.

Notes: Securities on loan also include securities borrowed from sources other than those captured in the value of securities available for lending. In addition to changes in the quantity of securities, the value of lendable and borrowed securities is affected by changes in the price of those securities. The vertical lines indicate the dates on which the respective countries requested EU/IMF financial assistance.

securities were falling and borrowed quantities must, therefore, have been increasing. Third, the value of Greek and Irish government debt securities available for lending dropped significantly immediately after the respective requests for EU/IMF financial support. Finally, after the requests for financial assistance, both the lendable and the borrowed amounts of Greek, Irish and Portuguese government debt securities have generally continued to decline.

All in all, the euro area government debt securities lending market is a large and important segment of the global securities lending market, which itself represents a substantial part of the global shadow banking system. Given the scarcity of publicly available information, relatively little is known about the prices, activity levels and risk exposures in this market. However, a more widespread use of central counterparties and trade depositories could lead to both better transparency and lower potential risks to financial stability. Moreover, some aspects of the market are rather unique, so that, as has been explained in this box, due care should be exercised when interpreting even basic supply and demand indicators of this particular market.