TLTRO III Participation

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ECB Money Market Contact Group 16/06/2021

- Introduction
- TLTRO-III deep dive
- Special rate & lending target
- Borrowing allowance: what’s left ?
- TLTRO-III collateral
- Terms and additional operations during 2021
- Early repayment estimates and considerations
- Concluding remarks

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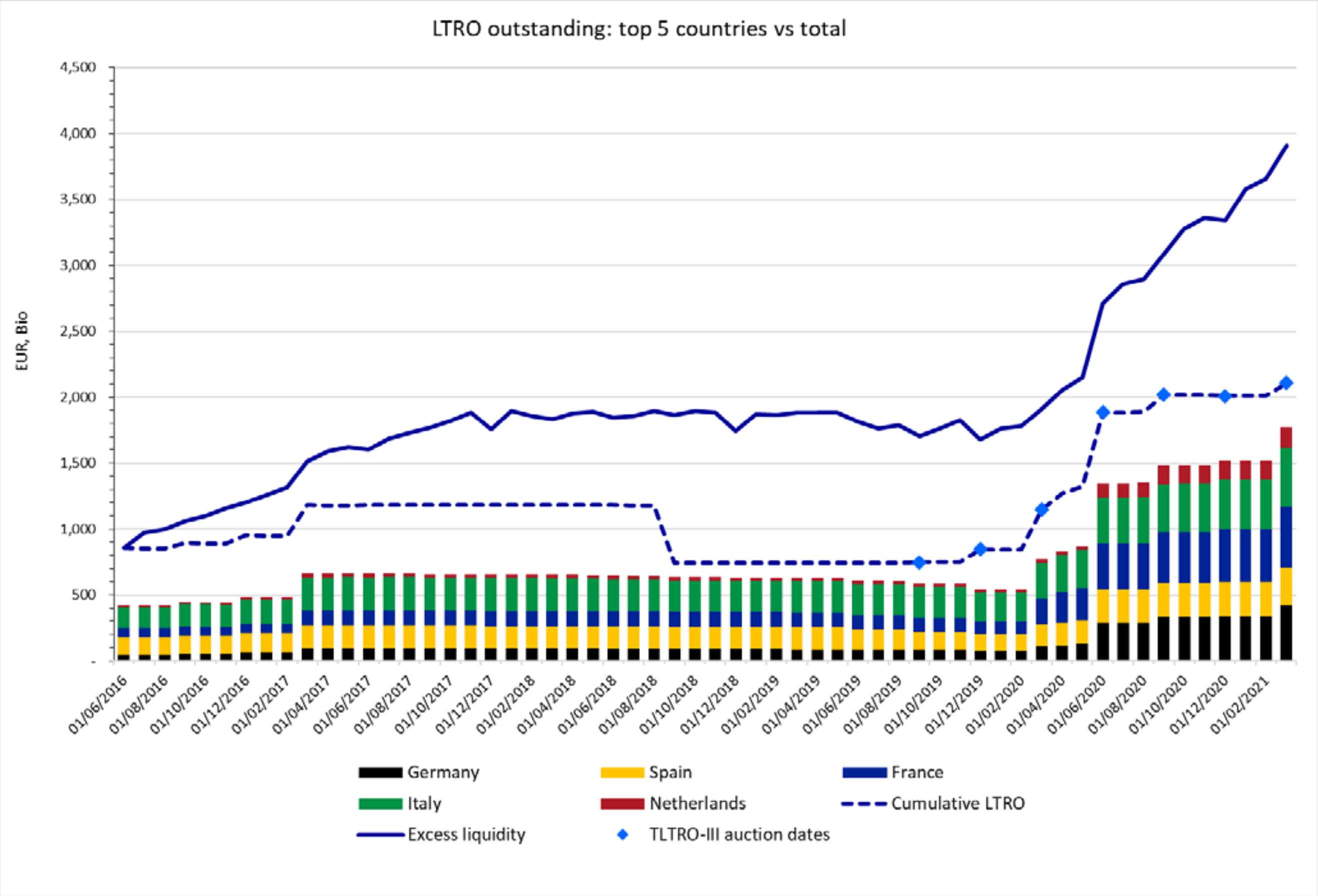
Introduction

In the introductory statement of last week's General Council meeting, president Christine Lagarde said that funding obtained through the third series of targeted longer-term refinancing operations (TLTRO- III) played a crucial role in supporting bank lending to firms and households. An ample degree of monetary accommodation is still necessary to support the economic activity and the robust convergence of inflation to levels that are below, but close to, 2 percent over the medium term.

As a result, those operations led to a strong increase in excess liquidity, on top of the already high levels linked to asset purchase programs. However, the TLTROs were needed because there is a potential passing through of higher interest rate levels to tighter financial conditions for corporates; currently not yet for households which are still at the lowest level in history.



TLTRO-III deep dive

The outstanding amount in all TLTRO-III programs stands at €2,107 bn.

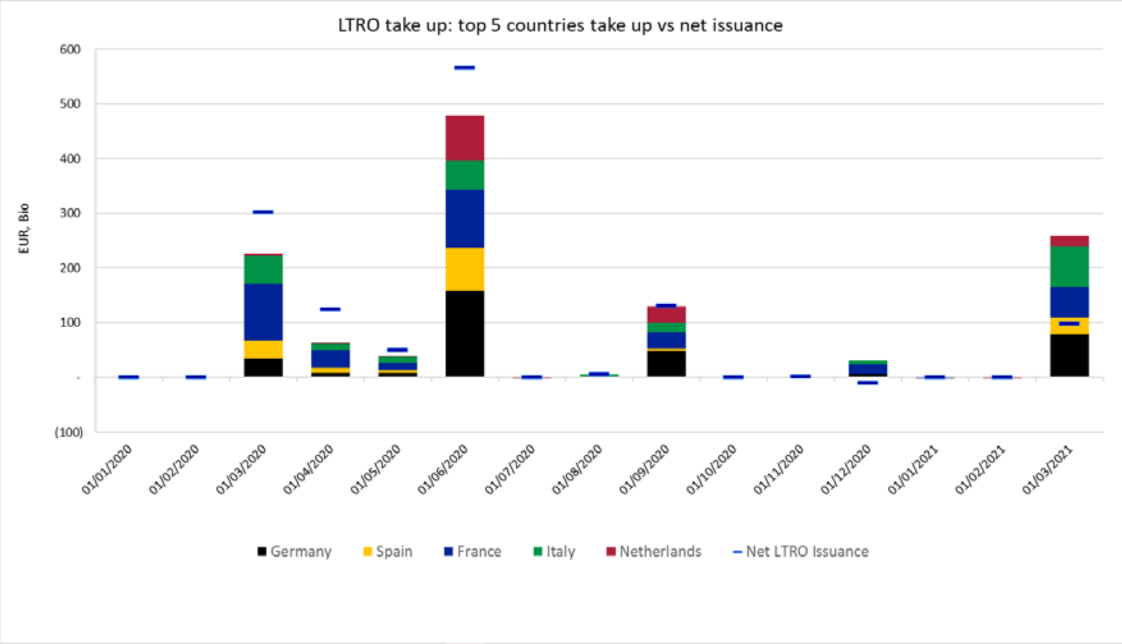
TLTRO-III.4 saw by far the largest take-up (€1,308bn), followed by the latest TLTRO-III.7 with an amount of €330.5Bn.

Auctions TLTRO-IIII.3 & III.4 saw a big average amount allotted per bid and also saw an important net issuance as seen in the graph on the right.

Whereas the initial TLTRO III goal was to avoid a cliff effect from the maturing TLTRO II, in terms of liquidity needs and ratio fulfilment, the reasoning for participation evolved more towards opportunistic bidding once the conditions were made more attractive.

At the start of the Covid-19 crisis, participation in the different LTROs was clearly needed for liquidity purposes but one can indeed notice that the 5 most important countries in terms of outstanding TLTRO-III amount came up in a significant way when the special interest of -1% came into play, as seen by the amount allotted for the fourth auction.

Programme	Settlement date	Alloted amount (EUR, mio)	Average amount per bid (EUR,mio)
TLTRO-III.1	25/09/2019	3,400.00	121.29
TLTRO-III.2	18/12/2019	97,720.00	800.97
TLTRO-III.3	25/03/2020	114,980.00	1,008.59
TLTRO-III.4	24/06/2020	1,308,430.00	1,763.39
TLTRO-III.5	30/09/2020	174,460.00	449.65
TLTRO-III.6	16/12/2020	50,410.00	323.16
TLTRO-III.7	24/03/2021	330,500.00	777.65



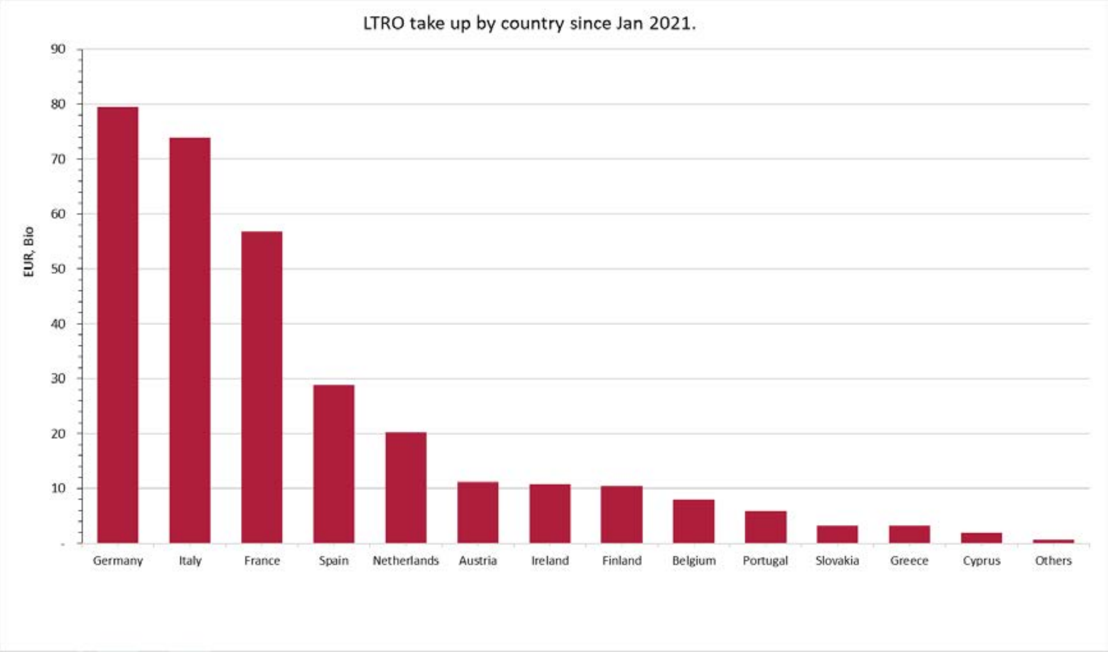
TLTRO-III deep dive (ctd.)

The strong interest in the latest auction can likely be explained by the decisions of the December 2020 meeting with the increase in allowance (55% up from 50%) and the extension of the special rate period to June 2022.

Its is also reasonable to assume that some confidence regarding the lending targets led some banks to take some additional funding at this auction.

Increase of participation was highest in Germany, Italy, France and Spain at the seventh auction.

As most banks have become even more liquid during the pandemic (asset purchase programmes, growth in customer deposits…), the main reason for their participation is the favourable rate of -1%.



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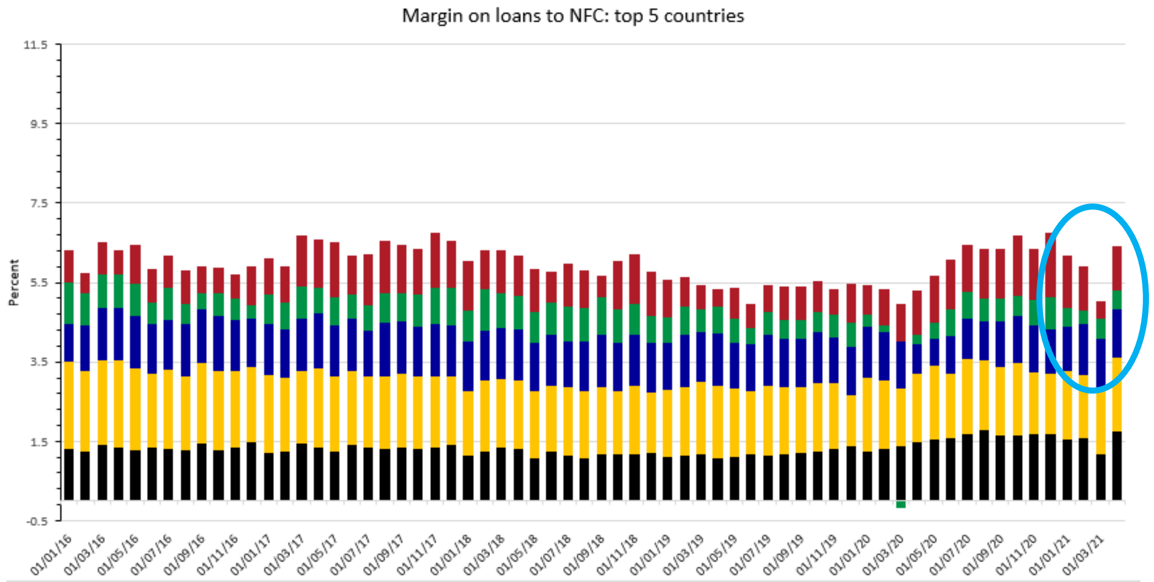
Special rate & lending target

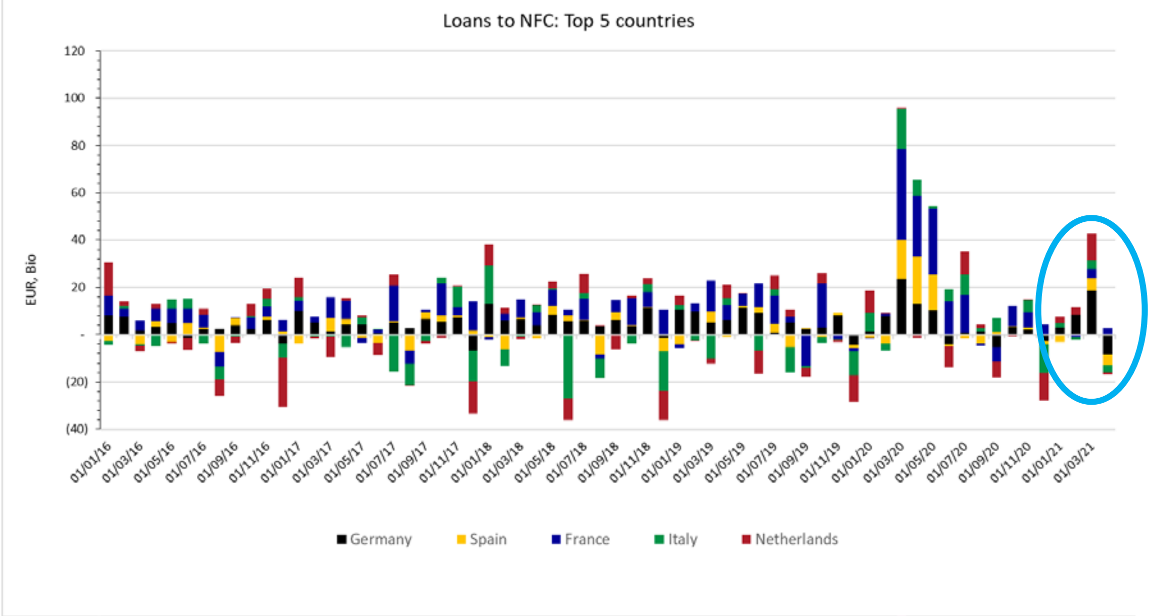
The increase in allowance decided by the Governing Council might have had an impact on the bidding behaviour of the March auction, as said earlier.

In order to benefit from the special interest rate, banks need to ensure they met the eligible lending thresholds.

Looking in more detail into the lending to non-financial corporations in terms of margins and volume, it can be noticed that a compression of margins and a corresponding increase in volume is clearly identifiable in March 2021, which corresponds to the lending target deadline.

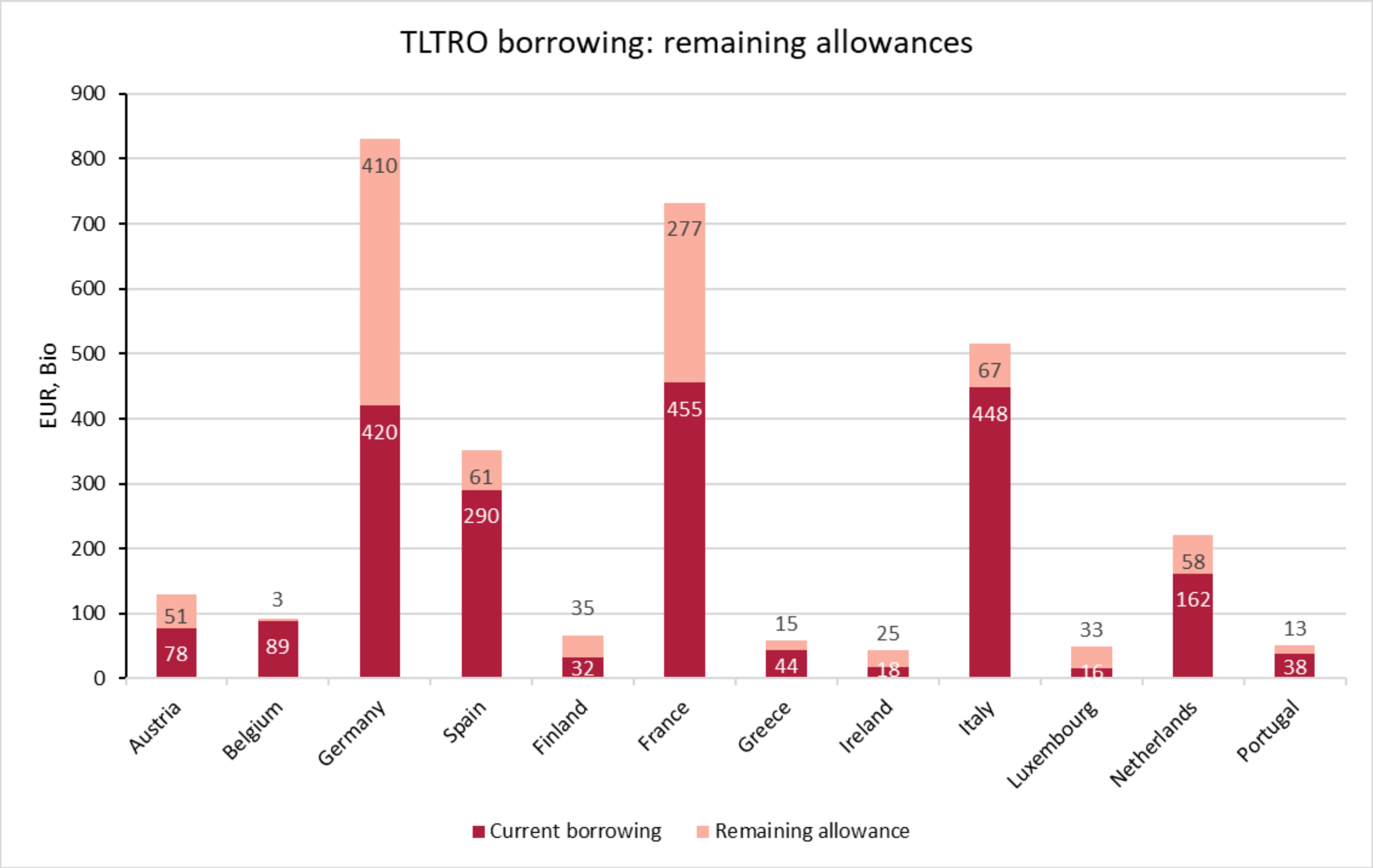
That trend reversed in a significant manner in April 2021, when the deadline had passed.





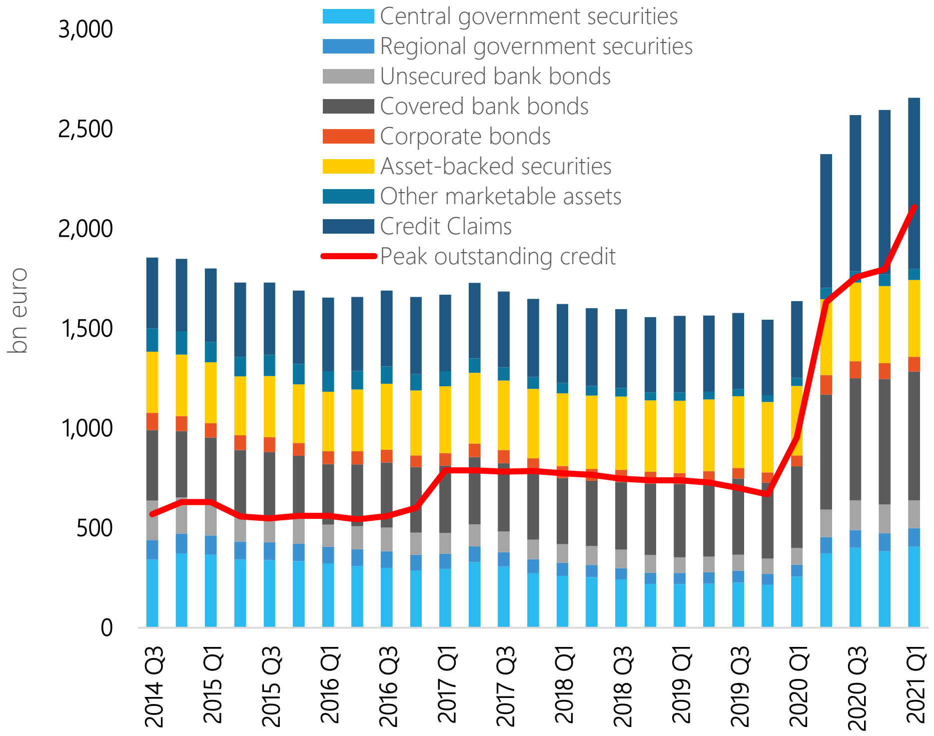
Borrowing allowance: what's left ?

A key factor in estimating the future take up of TLTRO-III will be the remaining allowance for each bank. As shown below, most countries have consumed already a significant part of their total allowance, especially Belgium, Italy and Portugal. Only France and Germany and to a lesser extent, Austria, Italy and the Netherlands have the potential to further borrow larger amounts in the next auctions.



TLTROs: collateral

- April 2020: temporary expansion of the set of eligible assets and reduction of haircuts
- December 2020: Extended collateral easing measures until June 2022
- **Share of credit claims has risen from 24% to 32% of total collateral in use**



	Central govt. securities	Regional govt. securities	Unsec. bank bonds	Covered bank bonds	Corp. bonds	ABS	Other marketable assets	Credit Claims	Total, bn euros
2019 Q1	14%	4%	5%	23%	4%	23%	3%	25%	1.563
2019 Q2	14%	4%	5%	24%	3%	23%	2%	24%	1.565
2019 Q3	14%	4%	5%	24%	3%	23%	2%	24%	1.577
2019 Q4	14%	4%	5%	25%	3%	23%	2%	24%	1.543
2020 Q1	16%	4%	5%	25%	3%	21%	2%	24%	1.636
2020 Q2	16%	3%	6%	24%	4%	16%	2%	28%	2.374
2020 Q3	16%	3%	6%	24%	3%	15%	2%	31%	2.570
2020 Q4	15%	3%	6%	24%	3%	15%	2%	32%	2.595
2021 Q1	15%	4%	5%	24%	3%	14%	2%	32%	2.657

+1 trn

Source: ECB, https://www.ecb.europa.eu/paym/coll/charts/html/index.en.html

TLTROs terms and additional operations during 2021

- Three operations are scheduled for the remainder of the year 2021, with the following allotment dates: **17-jun, 23-sept, 16-dec**

- Expectations for **take up in June are significantly lower than in March** and perhaps even lower in September and December.

June-21 : End of special interest rate of -1% period for the benchmark (March 2020 to March 2021)

- The March take up was mostly related to:
  - Using the additional TLTRO borrowing capacity after the ECB decided to increase the borrowing allowance to 55% of eligible loans.
  - The last opportunity for banks to benefit from the special borrowing rate of -1% for at least three months (related to the special period June 2020 to June 2021). Most banks already knew that they would meet their lending benchmark (March 2020 to March 2021)
- In June these considerations are less relevant.
- The take up in June will be driven by the trade-off between **extending maturity and having lost the opportunity to benefit from -1%** for 3 months (from March to June)

September 2021 / December 2021 : to roll or not to roll

- Considering current conditions, the September and December take up will be related to the possibility of **rolling some operations**, foregoing the special rate of -1% for 3 months (June to September 2021), but extending the maturity of the TLTRO financing at -0.5%
- In December banks not achieving the lending benchmark (Oct-20 to Dec-21) could decide for early repayment and not to roll positions. End of year balance sheet constraints could lead banks to reduce the outstanding amount of TLTROs and reserves at the ECB .
- In December banks will know if they meet the lending benchmark and could decide to take advantage of the special rate for the remaining 6 months

- **To sum up, low participation in upcoming operations is expected.**

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TLTRO: early repayment estimates and considerations

- Exemption of banks reserves for Leverage Ratio expected to expire in June 2020, limiting TLTRO take up

- Without an extension of the favorable terms, large amounts of TLTROs are expected to be repaid in June 2022 pushing up unsecured interest rates as banks replace TLTRO for market funding.

  - EURIBOR forwards reflect some risk of TLTRO repayment (not in September this year but starting in June 2022)

	EUR OIS, %	EURIBOR 12m Forwards, %	Spread, bps
jun-21	-0.48	-0.48	0
sep-21	-0.48	-0.45	3
dic-21	-0.48	-0.43	5
mar-22	-0.48	-0.40	8
jun-22	-0.48	-0.37	11
sep-22	-0.48	-0.35	13
dic-22	-0.48	-0.31	17
mar-23	-0.48	-0.27	21
jun-23	-0.47	-0.23	24
sep-23	-0.46	-0.19	27
dic-23	-0.45	-0.14	31
mar-24	-0.23	-0.10	12
jun-24	-0.43	-0.06	37
jun-25	-0.39	0.11	50
jun-26	-0.33	0.28	61

- Investors expect some sort of extension of the favorable interest rate (until December 2022 or June 2023) and TLTRO maturity.

Without these extensions:

- From now on, an expected early repayment in June 2022 need to be taken into account in NSFR calculations since the remaining TLTRO maturity is less than one year and as such needs to be computed as ASF at only 50%. Once the remaining maturity falls below six months it will be computed at 0%. All in all, increasing funding needs and tightening market conditions.

- With no additional benefits from a favorable interest rate, the impacts on Leverage Ratio and balance sheet constraints could lead to a reduction in reserves and outstanding TLTRO balances.

"…TLTRO played a crucial role in supporting bank lending to firms and households…"

Two important TLTRO conditions expire at the same time, in June 2022.
- End of special rate of -1%
- End of eased collateral rules

The end of these very special conditions could lead to a tightening of lending conditions, because
- banks have to repay TLTROs because some collateral can no longer be used
- pushing up unsecured interest rates as banks replace TLTRO for market funding

Given that one of the ECB's priorities is to preserve favorable financing conditions and TLTROs are a very efficient instrument of liquidity provision, the cliff effect of current terms of TLTROs have to be assessed in order to avoid tightening financing conditions prematurely and in a significant way.

The exit from the generous conditions should be managed carefully given the significant amount of outstanding TLTRO borrowing, its importance for banks in extending credit to firms and households and the contribution of this measure to banks' profitability.

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