The ECB's targeted longer-term refinancing operations have increased bank lending to the private sector

3 Apr 2019 – Analysis – Monetary policy

In recent years, the ECB has supported bank lending in the euro area by offering long-term financing to banks. The aim of the longer-term refinancing operations (LTROs), the most recent one in particular, was to encourage banks to increase lending to the private sector. LTROs have played a major part in the ECB's unconventional monetary policy of recent years, and the latest series of operations appears to have increased bank lending to firms.

In March 2016, the Governing Council of the ECB decided to launch a new series of targeted longer-term refinancing operations (TLTRO II), providing banks with low interest rate funding from the ECB. The first TLTRO II loans will mature in summer 2020.

The objective of the TLTROs has been to enhance the transmission of monetary policy to the real economy by incentivising banks to increase lending to firms and households. Increased credit supply boosts investment and spending, which again increases aggregate output and reduces unemployment, consequently supporting the ECB's price stability objective. With these operations, the Eurosystem aimed to accelerate inflation in 2014–2016 and to deflect the threat of deflation. The TLTROs have been a part of the ECB's non-standard monetary policy that has also included securities purchase programmes, among other measures.[1]

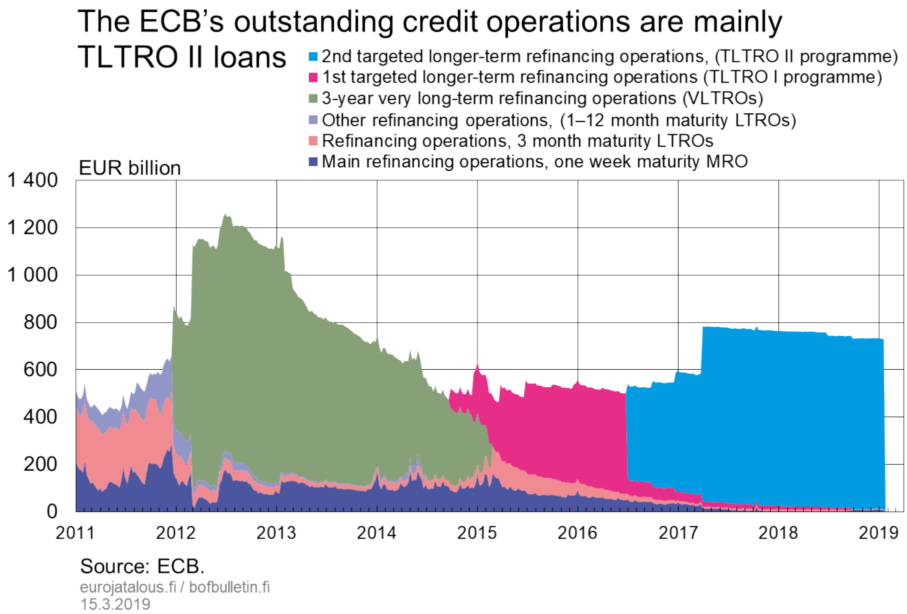
Under the TLTRO II programme, the ECB offered banks collateral-backed long-term central bank funding at a low interest rate. The series of quarterly targeted longer-term refinancing operations was launched in summer 2016. In these operations, with a maturity of four years, banks were entitled to borrow up to 30% of their stock of eligible loans as at 31 January 2016.[2] The interest rate applied in these operations was fixed at the rate on the main refinancing operations. However, banks were offered a strong incentive to increase lending: if a bank under the TLTRO II programme increased lending to firms and households (excluding loans for house purchase) above a certain threshold, the interest rate could actually be cut below zero (down to –0,40%).[3]

Before announcing the TLTRO II programme, the ECB had already conducted several-year-long funding operations, the first of which began at the end of 2011.[4] The new operations launched in 2016 differed from previous operations in that they incorporated much stronger incentives to increase lending to firms and households.

The TLTRO II programme was well received by the banks, which borrowed a total of EUR 739 billion under the scheme.[5] Chart 1 illustrates the historical development of total loans under the ECB's refinancing operations. As the chart shows, central bank credit obtained by banks consists almost exclusively of TLTRO II loans. Banks may also apply for short-term central bank credit; however, TLTRO II loans currently make up around 98% of the ECB's credit operations. The remaining 2% consists of one-week MROs and three-month LTROs. The current total outstanding amount under the ECB's refinancing programmes is around EUR 730 billion. This means that the refinancing operations also constitute a considerable part (16%) of the balance sheet of the Eurosystem, which currently stands close to EUR 4 700 billion.

1. More information about other unconventional measures and their implementation can be found in the article The financial crisis changed the instruments but not the objectives of monetary policy.
2. Eligible loans were defined as those to euro area non-financial corporations and households (excl. loans for house purchase), less any amount which was still outstanding under the TLTRO operations conducted in 2014.
3. See the ECB's press release for technical details: https://www.ecb.europa.eu/press/pr/date/2016/html/pr160310_1.en.html.
4. In December 2011 and February 2012, the ECB conducted very long-term refinancing operations (VLTROs) with a three-year maturity. The first TLTRO programme was conducted between September 2014 and June 2016. Loan maturity varied from two to four years, depending on when the loan was taken out.
5. In the first operation in June 2016, a total of 514 banks borrowed EUR 399 billion under the TLTRO II programme. The ECB publishes data on individual operations, including the number of bidding banks and the total amount allotted in the programme: https://www.ecb.europa.eu/mopo/implement/omo/html/index.en.html

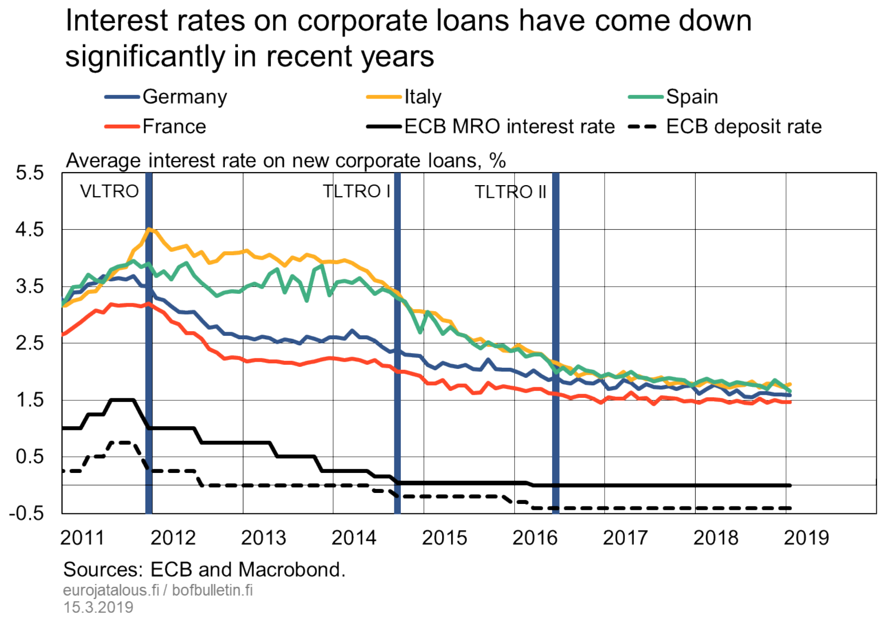
Chart 1



In 2013–2014, a problem for monetary policy in the euro area was that low interest rates did not pass through to lending rates and bank lending to firms was subdued. Chart 2 shows that bank lending rates did not decline in 2013–2014 although the ECB had lowered the policy rate. Through the targeted operations, the Governing Council has striven to lower the long-term funding costs of banks with the aim of lowering corporate loan interest rates. As the chart shows, the ECB's measures to support lending combined with other measures to lower the interest rates, such as lowering the policy rate and the expanded asset purchase programme, appear to have been effective. Research supports the assertion that lowered funding costs for banks caused by the refinancing operations lowered the interest rates on corporate loans.[6] This development can, however, also be attributed to numerous other contributing factors, including decreased uncertainty.

6. For instance, Altavilla et al. (2019) and Dijk & Dubovik (2018) have noted that the TLTRO loans have lowered the interest rates on corporate loans.

Chart 2



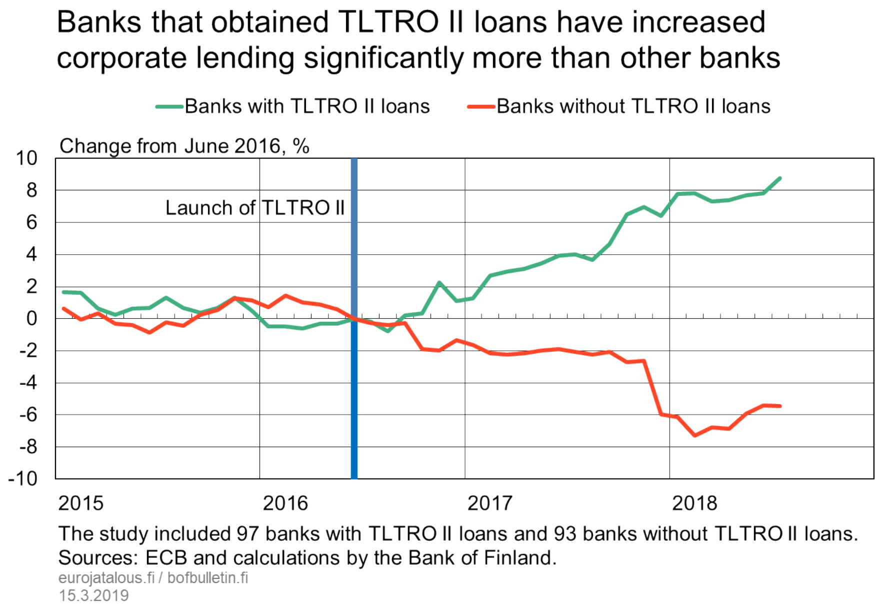
Banks that took TLTRO II funding appear to have increased corporate lending more than those that did not participate in the operations.[7] Chart 3 examines the development of banks' corporate loan stocks in these two categories: the green line represents the average growth rate of corporate lending in banks that participated in TLTRO II, while the red line represents the respective growth rate in banks that did not participate in the operations. Loan stock development was very similar in both categories until the summer of 2016. At the beginning of TLTRO II, however, the corporate loan stock began to increase rapidly in banks that participated in the operations, while the loan stock in other banks began to decline. This means that TLTRO II most likely increased corporate lending in participating banks.[8] A corresponding development can be seen in consumer credits. Therefore, it would seem that targeting the operations on corporate and household lending produced the desired effect.

The ECB's refinancing operations have also sparked criticism. For example Crosignani et al. (2017) noted that as a result of the three-year LTROs (VLTROs) conducted in 2011 and 2012, banks increased their government bond holdings, consequently intensifying the negative feedback loop between banks and sovereigns. However, unlike the early VLTRO loans, loans granted under the TLTRO programmes since 2014 have been strongly targeted at the real economy.

---

7. This analysis made use of the ECB's IBSI data featuring the monthly balance sheets of around 300 banks. Some banks were ruled out due to data deficiencies or because their balance sheets did not include corporate loans.
8. The research regarding TLTRO II loans is focused on the programme's effects on interest rates (see footnote 6). Andrade et al. (2018), Boeckx, De Sola Perea & Peersman (2017), Boeckx, Dossche & Peersman (2017), Carpinelli & Crosignani (2017) and Darracq-Paries & De Santis (2015) have noted that previous untargeted VLTRO loans increased bank lending, which is why there is reason to believe that TLTRO loans targeted to stimulate lending would increase bank lending significantly.

Chart 3



Because the ECB’s refinancing operations have increased bank lending, they have also indirectly boosted consumption and investment as well as accelerated inflation.[9] Thus, the ECB's recent refinancing operations have moved the economy in the desired direction. Banks have had the option to repay TLTRO II loans prematurely since last summer. So far, very few banks have been interested in early repayment of the cheap central bank credit.

In March, the Governing Council of the ECB decided to launch a new series of targeted longer-term refinancing operations (TLTRO III). The TLTRO III programme consists of quarterly operations starting in September 2019 and ending in March 2021. Each operation has a maturity of two years and the rate is indexed to the interest rate on the main refinancing operations over the life of each operation. Under TLTRO III, banks will be entitled to borrow up to 30% of the stock of eligible loans as at 28 February 2019. Like the outstanding TLTRO programme, TLTRO III will feature built-in incentives for credit conditions to remain favourable. These new operations will help to preserve favourable bank lending conditions and the smooth transmission of monetary policy.

Sources

Altavilla, C., Canova, F. & Ciccarelli, M. (2019) Mending the broken link: heterogeneous bank lending rates and monetary policy pass-through. Journal of Monetary Economics.

Andrade, P., Cahn, C., Fraisse, H. & Mésonnier, J. S. (2018) Can the Provision of Long-term Liquidity Help to Avoid a Credit Crunch? Evidence from the Eurosystem’s LTRO. Journal of the European Economic Association.

---

9. The consequences of TLTROs have been studied by Balfoussia & Gibson (2016), whereas the consequences of VLTROs have been studied by Boeckx, Dossche & Peersman (2017) and Darracq-Paries & De Santis (2015).

Balfoussia, H. & Gibson, H. D. (2016) ‘Financial conditions and economic activity: the potential impact of the targeted long-term refinancing operations (TLTROs)’, Applied Economics Letters 23(6), 449–456.

Boeckx, J., De Sola Perea, M. & Peersman, G. (2017) The transmission mechanism of credit support policies in the Euro Area.

Boeckx, J., Dossche, M. & Peersman, G. (2017) ‘Effectiveness and Transmission of the ECB’s Balance Sheet Policies’, International Journal of Central Banking 13(1), 297–333.

Carpinelli, L. & Crosignani, M. (2017) The effect of central bank liquidity injections on bank credit supply.

Crosignani, M., Faria-e-Castro, M. & Fonseca, L. (2017) The (unintended?) consequences of the largest liquidity injection ever.

Darracq-Paries, M. & De Santis, R. A. (2015) ‘A non-standard monetary policy shock: The ECB's 3-year LTROs and the shift in credit supply’, Journal of International Money and Finance 54, 1–34.

Dijk, M. van & Dubovik, A. (2018). Effects of Unconventional Monetary Policy on European Corporate Credit. CPB Discussion Paper, 372.

Tags

euro area banking sector, lending, TLTRO, longer-term refinancing operations