5 The targeted longer-term refinancing operations: an overview of the take-up and their impact on bank intermediation

Targeted longer-term refinancing operations (TLTROs) provide financing to euro area credit institutions with a maturity of up to four years at attractive conditions. Two series of operations were launched. The first series of eight operations (TLTRO-I) was announced in June 2014.[35] It was followed by a second series of four operations (TLTRO-II), announced in March 2016.[36] Under TLTRO-II, banks could borrow up to 30% of the amount of their existing stock of loans to non-financial corporations and households (excluding loans to households for house purchase). Moreover, banks were given the opportunity to repay funds borrowed under TLTRO-I early and switch to TLTRO-II funds. Such a shift of funding was rendered attractive for two reasons: first, it lengthened the maturity of bank funding and, second, it lowered the cost as the average cost of TLTRO-I funding stands at around 10 basis points, while the maximum rate banks will have to pay for TLTRO-II funding is zero.

The TLTROs provide incentives for bank lending to the real economy. In the case of TLTRO-I, the incentives for lending were two-fold. First, banks whose net lending over a reference period exceeded a bank-specific benchmark could borrow more in the final six TLTRO-I operations and the maximum additional amount was set at three times the amount by which their net lending had exceeded their benchmark. Second, banks which did not meet their lending benchmarks were required to repay their TLTRO-I borrowings early. Incentives for lending are provided in a different form under TLTRO-II. Rather than penalising banks that fail to meet their benchmarks, TLTRO-II provides rewards, in the form of lower interest rates, for banks which outperform their benchmarks. Banks whose eligible net lending in the period between 1 February 2016 and 31 January 2018 exceeds their lending benchmarks will benefit from a rate reduction. The TLTRO-II rate can be as low as −40 basis points.[37]

The TLTROs have eased bank funding conditions, ensuring that the monetary policy stimulus reaches euro area households and firms. The TLTROs reduced the marginal funding costs of banks that participated in the operations and, in

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[35] TLTRO-I was part of the credit easing package of measures which also included cuts in policy rates (bringing the deposit facility rate into negative territory for the first time) and the announcement of the intensification of work towards outright purchases of asset-backed securities. In addition, the use of the fixed rate tender procedure with full allotment in main refinancing operations was prolonged and the weekly fine-tuning operations to sterilise the liquidity injected under the Securities Markets Programme were suspended.

[36] For more details on TLTRO-II, see the box entitled "The second series of targeted longer-term refinancing operations (TLTRO II)", *Economic Bulletin*, Issue 3, ECB, 2016. There is a dedicated reporting scheme for TLTRO-II to track the net lending of participating banks. Its methodology is aligned with the methodology underpinning the MFI balance sheet statistics.

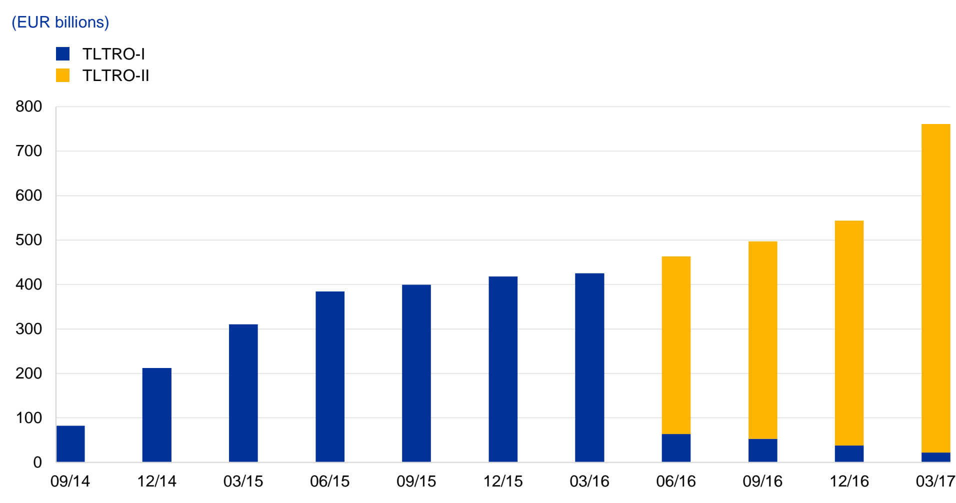
[37] Counterparties will qualify for this rate (the deposit facility rate prevailing at the time of allotment for each TLTRO-II operation) if their outstanding amounts of eligible loans (subject to certain adjustments, for example for loan sales and purchases and for securitisation) exceeds their benchmark stocks of eligible loans by 2.5% or more as at 31 January 2018. For amounts below this limit, the level of the interest rate will be determined on the basis of the percentage by which a counterparty exceeds its benchmark stock and will follow a linear graduation.

parallel, provided them with incentives to increase their supply of targeted credit. The design of the measure thereby ensured that the reduction in funding costs that banks benefit from is passed on to borrowers. Moreover, to the extent that market-based funding has been replaced with TLTRO funding, the measure has contributed to a reduction in the supply of bank bonds. All other things being equal, a decline in bank bond issuance generally reduces banks' bond market funding costs, further easing funding conditions both for banks that bid in the TLTRO operations and for those that did not. The resulting more favourable credit conditions for borrowers (when the reduction in funding costs is passed on) in turn encourage borrowing and expenditure for investment and consumption.

Banks' total TLTRO-II borrowings currently stand at €739 billion. The first TLTRO-II operation (TLTRO-II.1, settled in June 2016) attracted bids amounting to €399 billion, which largely reflected shifts out of TLTRO-I funding and into TLTRO-II funding (see Chart A). The second and third TLTRO-II operations (TLTRO-II.2 and TLTRO-II.3) allotted €45 billion and €62 billion respectively. Take-up in the final operation (TLTRO-II.4) was substantially higher at €233 billion, of which a significant share (€216 billion) constituted a net increase in TLTRO borrowings. The significant take-up in the final operation reflects the overall attractive pricing of TLTRO-II compared with banks' alternative market-based funding, and, to some degree, incentives for back-loading take-up.[38] Overall, outstanding TLTRO credit (including outstanding TLTRO-I credit) stood at €761 billion as at end-March 2017 and was concentrated in the first and final TLTRO-II operations (see Charts A and B).

Chart A

Evolution of banks' gross TLTRO borrowings

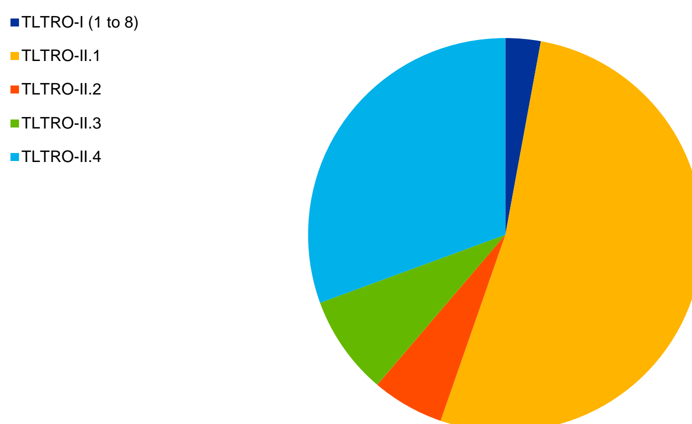


Source: ECB.

[38] Such incentives to postpone take-up arose for several reasons. First, market participants were expecting further cuts in policy rates at the time of bidding for TLTRO-II.1 and TLTRO-II.2. Postponing take-up may have been preferable at that point in time in order to lock-in the lowest possible rate. Moreover, back-loading take-up extends the tenor of the operation, over which market rates are likely to rise. Finally, it reduces the uncertainty surrounding the final TLTRO-II rate, as banks had observed developments in their eligible loans for half of the reference period by the time they came to bid for TLTRO-II.4 funding. This information allowed them to make a more accurate assessment of whether and by how much they were likely to outperform their lending benchmarks.

Chart B

Composition of outstanding TLTRO credit as at end-March 2017



Source: ECB.

The joint impact of TLTRO-I and TLTRO-II on bank intermediation cannot be easily split into the separate contributions of the two series at present. While high bidding volumes are welcome, they do not constitute the right metric for assessing the effectiveness of the two TLTRO series. The measure of success is rather the improvement in funding conditions of final borrowers brought about by the TLTROs. Given the large set of banks that bid in both series, the significant rollover of TLTRO-I funding into TLTRO-II funding and the relatively short period since the settlement of the first TLTRO-II operation for which bank lending data are available, it is currently difficult to split the overall impact of the TLTROs into the contribution of TLTRO-I and the additional impact of TLTRO-II. Instead, evidence of their joint impact on bank intermediation is provided below.

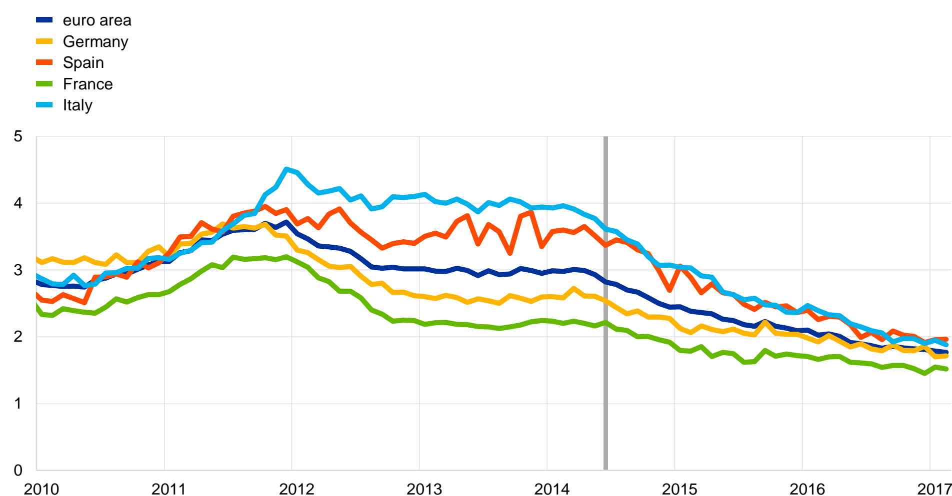
The TLTROs, together with the other non-standard measures introduced since June 2014, have proven effective in supporting the transmission of lower policy rates into better borrowing conditions for the euro area non-financial private sector. The rates on loans to non-financial corporations declined markedly immediately after the announcement of the first series of TLTROs (see Chart C). The declines were sharper in countries where the composite lending rates to non-financial corporations had been elevated, thus, overall, the cross-country dispersion of lending rates also declined in parallel. Moreover, in vulnerable countries, banks that borrowed under TLTRO-I reduced their rates by more than banks that abstained from bidding.[39] Finally, banks surveyed in the euro area bank lending survey have repeatedly reported that the TLTROs – including those of the second series – have contributed to an easing of the terms and conditions on loans to enterprises and, albeit to a lesser extent, an easing of credit standards (see Chart D).

[39] See the article entitled "The transmission of the ECB's recent non-standard monetary policy measures", *Economic Bulletin*, Issue 7, ECB, 2015.

Chart C

Composite lending rates for non-financial corporations

(percentages per annum)

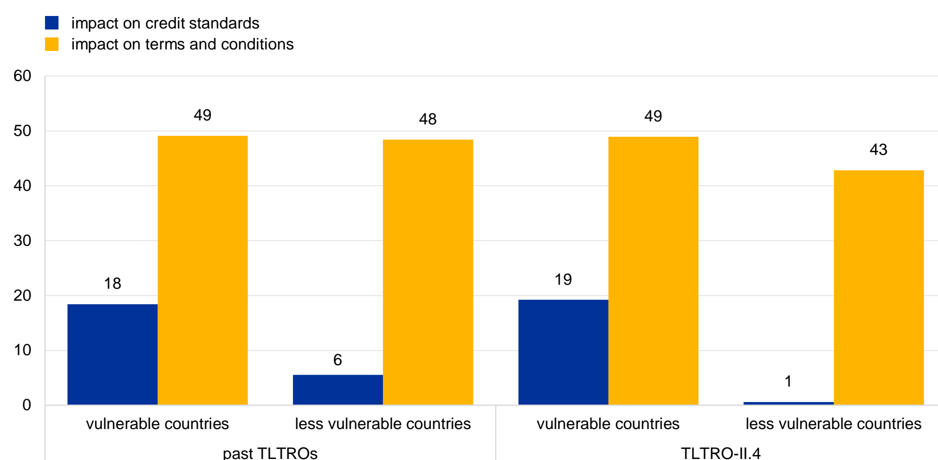


Source: ECB.
Notes: The vertical line denotes the announcement of the credit easing package of measures (which included TLTRO-I) in June 2014. The latest observation is for February 2017.

Chart D

Easing impact of past TLTROs and the expected easing impact of TLTRO-II.4 on credit standards and terms and conditions on loans to enterprises

(percentages of survey respondents indicating that the TLTROs contributed considerably and contributed somewhat to an easing of credit standards and terms and conditions in the January 2017 euro area bank lending survey)



Source: January 2017 euro area bank lending survey.
Notes: The survey responses refer to the impact of all past TLTROs and the impact of TLTRO-II.4 on bank lending conditions. Vulnerable countries are Ireland, Greece, Spain, Italy, Cyprus, Portugal and Slovenia. Less vulnerable countries are the remaining euro area countries.

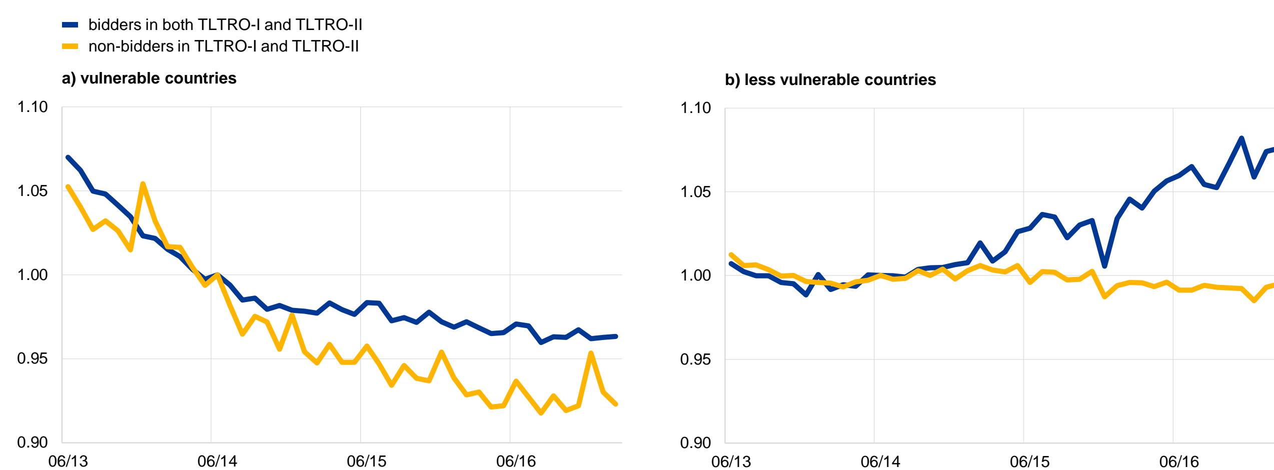
The TLTROs seem to be supporting higher intermediation volumes in less vulnerable euro area countries and a slowdown of the contraction in bank lending in vulnerable countries. Chart E compares the evolution of lending to non-financial corporations by the set of banks that bid in both TLTRO-I and TLTRO-II with lending by banks that did not participate in any operations in the two series of TLTROs. Prior to the introduction of TLTRO-I net lending by both groups of banks evolved largely in parallel. Lending by banks that did not participate in the TLTROs

appears to have remained largely unchanged subsequently. In vulnerable countries, they have continued to shed loans at a relatively stable pace and there has been only a very gradual slowdown in the contraction in lending by this group of banks. By contrast, banks that bid in both series of TLTROs have significantly reduced the pace at which they had been cutting lending to non-financial corporations. In less vulnerable countries, bidders appear to have increased intermediation volumes.

Chart E

Lending to non-financial corporations by TLTRO bidders and non-bidders

(index: June 2014 = 1)



Source: ECB.
Notes: The chart shows the evolution of a notional stock of loans to non-financial corporations based on a sample of MFIs for which information is available at the individual MFI level. The notional stock is constructed by adding the cumulated net flows of loans to non-financial corporations over the relevant period to the stock of loans to non-financial corporations as at June 2013. The chart depicts the aggregate evolution of lending by the group of banks that borrowed under both TLTRO-I and TLTRO-II and lending by the group of banks which did not access any operations in the two series. Vulnerable countries are Ireland, Greece, Spain, Italy, Cyprus, Portugal and Slovenia. Less vulnerable countries are all other countries of the euro area. The group of bidders in vulnerable countries comprises 48 counterparties and the group of non-bidders comprises 35. In less vulnerable countries, the group of bidders comprises 43 counterparties, while the group of non-bidders comprises 91. The data are not seasonally adjusted and therefore exhibit at times strong end-of-year effects. The latest observation is for February 2017.

The full impact of the TLTROs is still unfolding. While the pass-through of the first TLTRO series into improved bank lending conditions is already advanced, the full impact of TLTRO-II is still to materialise, as the concomitant funding cost benefit for banks is only gradually being passed on to borrowers in the form of better terms and conditions and less stringent credit standards on new bank loans. It is also worth recalling that the take-up in TLTRO-II.1 was by and large driven by shifts out of TLTRO-I funding. Significant take-up net of redemptions of TLTRO-I funding occurred only in TLTRO-II.4. The impact of this final operation is yet to materialise.