Box 4

THE IMPACT OF THE FIRST THREE-YEAR LONGER-TERM REFINANCING OPERATION

The aim of the additional non-standard monetary policy measures decided by the Governing Council on 8 December 2011 was to ensure that monetary policy continues to be effectively transmitted to the real economy, thereby supporting the ability of banks to maintain and expand lending to euro area households and non-financial corporations. This is essential to safeguard price stability in the euro area.

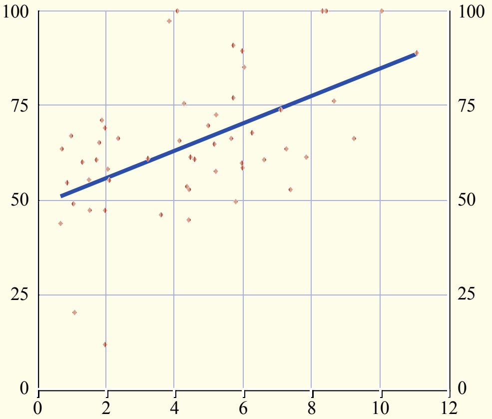
As part of the agreed package of measures, two longer-term refinancing operations (LTROs) with a maturity of three years were announced to support the supply of credit to the euro area economy. The first operation was conducted in December 2011, while the second will be conducted in February 2012.[1] Through these operations, carried out as fixed rate tender procedures with full allotment, the Eurosystem is in particular ensuring that banks continue to have access to stable funding with longer maturities. This, in turn, will limit the impact on euro area banks of the difficult conditions in funding markets. Additionally, after one year banks will have the option to repay outstanding amounts received in these operations, which gives them a high degree of flexibility, facilitating their liability management.

The first operation, conducted on 21 December 2011, provided €489,190.75 million to 523 credit institutions. This amount includes €45,721.45 million that was shifted from the 12-month LTRO allotted in October. A total of 123 counterparties chose this option, whereas 58 banks decided to retain the amounts they borrowed in the 12-month LTRO, which now has a remaining outstanding amount of €11,213.00 million. In addition, the amount of liquidity provided via weekly main refinancing operations and in the three-month LTROs declined substantially.

1 The first operation was allotted on 21 December 2011 and replaced the 12-month LTRO announced on 6 October. Counterparties were permitted to shift all of the outstanding amounts received in the 12-month LTRO allotted in October into the first three-year LTRO.

Chart A Rollover needs in the next three years and bidding behaviour

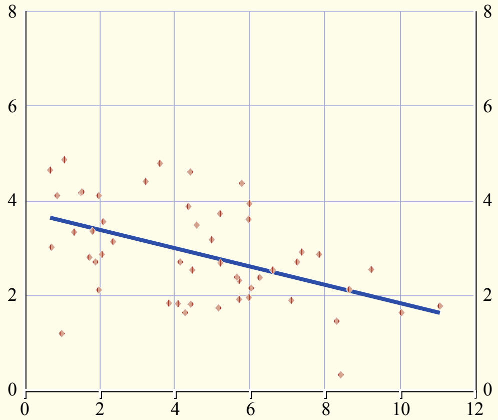
(y-axis: percentage of long-term debt securities maturing in 2012-14; x-axis: bid amount in the three-year LTRO as a percentage of total assets)



Sources: ECB, Fitch Ratings and DCM Dealogic.

Chart B Residual maturity of outstanding debt and bidding behaviour

(y-axis: weighted average residual maturity of outstanding longer-term debt securities (years); x-axis: bid amount in the three-year LTRO as a percentage of total assets)



Sources: ECB, Fitch Ratings and DCM Dealogic.

All in all, the increase in liquidity, as measured on the settlement day of the three-year LTRO, was equal to €193.4 billion. The record amounts allotted in the three-year LTROs to the banking system mechanically increased the quantity of base money in circulation and will therefore be reflected, at the aggregate level, in either the current accounts of banks or recourse to the deposit facility, irrespective of the use that individual banks make of the newly available liquidity.

Some remarks can be made regarding the bidding behaviour in the three-year LTRO. First, the large amount of liquidity obtained by euro area banks in this operation can be viewed as a reflection of their refinancing needs over the coming three years, as shown in Chart A. Measuring the rollover needs over a shorter horizon, for instance over the next six months, even though it captures the large amount of refinancing needed in the first half of 2012, does not fully explain the bidding behaviour. This suggests that medium-term funding considerations may have had a significant influence on the bidding behaviour. Indeed, in addition to assessing the rollover risk faced by banks, it is useful to consider the residual maturity of banks' outstanding debt. The longer the residual maturity, the lower the risk that banks will need to seek market funding under unfavourable conditions. Chart B illustrates a clear negative relationship between the size of the bids and the residual maturity of the bidders' debt. This also suggests that funding considerations may have played a major role in determining the bidding behaviour. Second, banks may have placed relatively high bids in the first three-year LTRO as they viewed the operation as attractively priced compared with the prices that could be inferred from the EURIBOR swap curves or the spreads required by the market for bond issuance in 2011.

Overall, the analysis suggests that funding considerations played a major role in the bidding behaviour of banks in this first three-year LTRO, supporting the Governing Council's view that the announced measures will help to remove impediments to access to finance in the economy, stemming notably from spillovers from the sovereign debt crisis to banks' funding markets.