22 June 2018

ECB Research

TLTRO2 – EUR11bn of voluntary repayments

The ECB just published the voluntary repayments of the second round Targeted Longer-Term Refinancing Operations (TLTRO2). Euro area banks decided to repay EUR11bn at the end of the month. **The EUR11bn was relatively low as expected, as banks generally have little incentive to repay at this stage**, see more later. Banks could, in theory, have repaid up to EUR399.3bn in this operation later this month. This month marks the first time where banks have the first possibility to repay voluntarily the first round of TLTRO2s that the ECB conducted from June 2016 to March 2017.

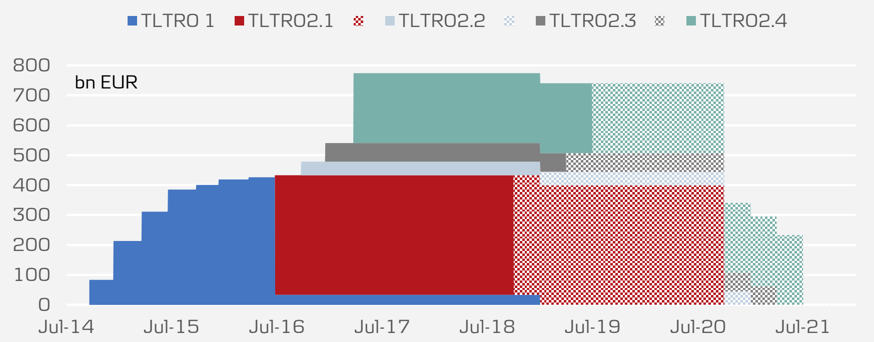
TLTRO – reminding ourselves

The ECB conducted two rounds of the Targeted Longer-Term Refinancing Operations (TLTRO), round one in 2014-16 and round two in 2016-17. Both operations were intended to target the real economy, but banks could also use the liquidity operations for long-term funding at favourable rates (all operations have a four-year maturity). In particular, this has been interesting due to the long maturity of the operations, making it possible for them to count towards the liquidity coverage ratios, such as NSFR.

As of this summer, two years after the first operation in June 2016, the four TLTRO2s can be repaid voluntarily on a quarterly basis starting this June. The first round TLTRO (also dubbed the 'stick approach' due to the incentive structure) has a remaining outstanding volume of around EUR30bn and will mature on 26 September 2018, while for the more important TLTRO2 from an excess liquidity point of view, the total outstanding volume is EUR740bn (EUR729bn as of 27 June).

The shaded area in the chart to the right indicates the early repayment possibility. We expect the majority of the TLTRO outstanding volume to be repaid close to maturity and at the earliest when the maturity is just less than one year. The TLTRO2 has to be repaid in full by June 2020 through March 2021.

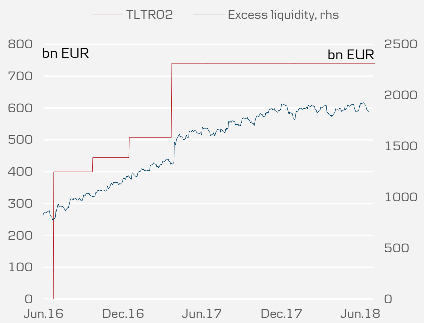
TLTRO allotment and repayment schedule



Source: Danske Bank

Note: shaded area indicate potential early repayment

TLTRO and excess liquidity



Source: ECB, Danske Bank

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Little incentive for early repayments

The ECB's TLTRO2 operations came with very favourable financing conditions, and a relatively easy target to meet. In short, leveraging countries (increasing loan growth) should increase their net lending by 2.5% from February 2016 to January 2018, from the benchmark period of February 2015-January 2016. Deleveraging countries (decreasing loan growth) should 'only' stop their lending trajectory.

Applying the methodology show that on average, the euro area banks will get the TLTRO funds at -40bp (deposit rate). This number is an average and does not show the individual countries, just as the country level does not show the individual bank data, i.e. some banks may pay higher than -40bp as indicated by the methodology. The country level data shows that among the 'core' European countries, it is only the Netherlands that does not get the deposit rate on its lending, while for peripheral countries, Italy and Cyprus will pay the MRO. Portugal will pay -21bp.

	DE	NL	AT	FR	FI	LU	BE	ES	IT	PT	IE	GR	SK	SI	LT	EE	LT	CY	MT	EA
Applied rate (%)	-0.40	0.00	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	0.00	-0.21	-0.40	-0.40	-0.40	-0.40	-0.27	-0.33	-0.40	0.00	-0.40	-0.40

Source: Danske Bank

The ECB does not reveal the country breakdown of the TLTROs, but the national central banks provide statistics on the outstanding LTRO amounts. Compiling these, and acknowledging that the NCB data totals EUR760bn and the TLTRO stands at EUR740bn, we find it fair to assume the numbers broadly reflect the TLTRO take-up.

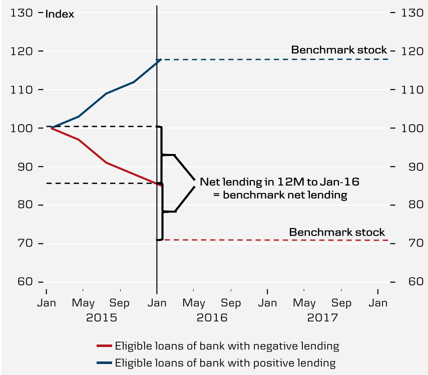
In the numbers we particularly note the Italian and Spanish take-up of EUR251bn and EUR170bn, respectively (or roughly 14.6% of GDP for both countries), while German is EUR94bn and EUR114bn for France. With the very favourable conditions for Germany, France and Spain, they have little incentive to repay at this stage, as there is no stigma attached to the TLTRO2s, unlike TLTRO1. That said, given the current Italian turmoil, a 0% LTRO with around EUR250bn taken, the Italian banks have very favourable conditions and we see very little incentive to any repayment in the coming quarters in Italy as well.

Impact on market pricing is very small at this stage

We believe that the impact on market pricing is very limited (non-existing) at this stage. Historical patterns show that once excess liquidity is above EUR250-300bn, the deposit rate is more important for EONIA and hence the ECB's transmission mechanism. EONIA has usually 4-5bp above the deposit rate with the elevated excess liquidity. With excess liquidity standing at EUR1820bn, the early repayment announced today is not expected to change that pattern anytime soon. For any material lower excess liquidity and impact on EONIA-depo spread, the ECB would have to reduce its balance sheet by a gradual stop to reinvestments, but that is not foreseen until 2021 at the earliest.

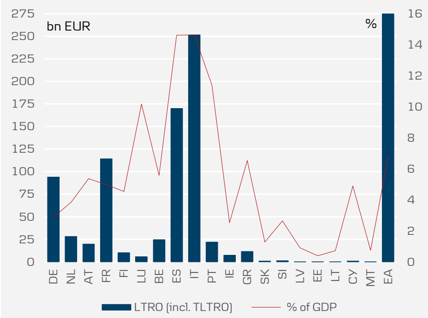
Towards the summer next year, when the TLTRO will have less than a year to maturity and the funds do not count towards the liquidity coverage ratios, such as NSFR, we may observe tightening liquidity conditions, albeit we still believe the majority of repayments will be done at expiry.

ECB benchmark rate methodology



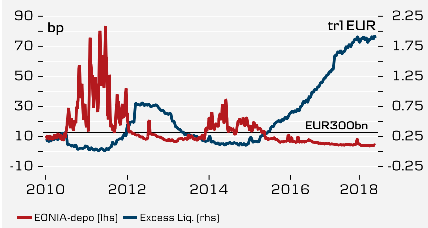
Source: Danske Bank

Outstanding LTRO lending



Sources: ECB, Danske Bank

Excess liquidity and EONIA-depo spread



Source: Bloomberg, Macrobond Financial, Danske Bank

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Expected updates

None.

Date of first publication

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