### ECB Money Market Contact Group

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# TLTRO-III assessment, expectations and its future.



- 1. TLTRO-III Modalities, critical changes.
- 2. March 2021 TLTRO-III take up.
- 3. Two types of TLTRO-III users.
- 4. Expectations for TLTRO-III.8-10 operations.
- 5. TLTRO-III conclusions.
- 6. For discussion: *TLTRO-IV*.

# 1. TLTRO-III modalities, critical changes.



#### TLTRO-III.1-7

- These can benefit from lower interest rate by exceeding thresholds in one or more of the 3 lending assessment criteria:
  - Initial Criterion: 1.15% from Apr'19-Mrch '21
  - <u>Special Criterion</u>: 0% from Mrch'20 Mrch'21
  - <u>Additional Special Criterion</u>: 0% from Oct'20 Dec '21
- Partly explains the high take up, March (nr.7) was the last possibility to have the benefit based on 3 lending criteria.

#### TLTRO-III.8-10

- These can only benefit from lower interest by exceeding the threshold of the additional special lending criterion.
  - Previous criteria cannot be applied as they have expired at the time of participation.

## 2. March take-up surprised everyone.



#### Take up TLTRO-III.7

- March demand (EUR 330bn) was much higher than expected (EUR ~50-200bn).
- Critical changes support this.
- Banks expectations of a surge in loan demand when the economy reopens in combination of extension of lower interest rate from Jun '21 – Jun '22.
- Yet demand remains relatively limited so far.
- Many banks have closed in on their new benchmarks, but in some key countries gaps remain.

#### Evolution of loans to corporates



Oct-Feb

## 3. Two types of TLTRO-III users.



- Substitute for market-based funding.
- Included this ECB tool into their funding mix.
- Price insensitive (as long as it is comparable/better than market).
- Bulk seen in early-TLTRO-III's.
- Likely to keep the funds beyond the discount periods.



Note: Banks could tick all use cases that applied, so total exceeds 100%. Data for Q2-Q3 2020. Source: ECB Bank Lending Survey

#### **B.** Opportunistic:

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- Using TLTRO-III as carry.
- Price sensitive, keeping the funds is a contingent on the discount (to a lesser extent developments in market rates, relative to base TLTRO-III rate).
- Bulk seen in TLTRO-IIIs postdiscount announce (4 and 7).
- Large III.7 take-up likely driven by expectations that benchmark will be met.
- Likely to repay (partially) after discount periods.

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## 4. Expectations for TLTRO-III.8/9/10 operations.



#### Benchmarks and discounts mostly relevant for the opportunistic group:

- Banks replacing TLTRO for market based funding (*A. group*) assumed to be less sensitive for the extra discount, as base TLTRO-III rate already attractive for them relative to market rates.
- December `21 (III.10) may see a bulky allotment, only in gross terms as banks switch out of earlier TLTRO-III's to extend funding by up to 2 years .
  - Banks can make a very good assessment in December of the eligible loans for the period oct-20 dec-21 which are applicable for the discount on III.10.
- This switch should give an indication of how sticky TLTRO-III is post-discount, (*B. group*) will likely be (partly) out.
- Upside risk to expectations:
  - Rising market-based rates on back of market enviroment.

## 5. TLTRO-III conclusions.



- Introduction is a success, reliance on the TLTRO-III is high.
  - Important to separate 'funding' from 'opportunistic' motive.
- Meeting lending benchmark.
  - European wide competition leads to:
    - Lower margin/higher (credit) risk acceptance.
- Reduced reliance of bank issuance as TLTRO-III becomes part of the funding mix.
  - Creates markets anomalies:
    - (money market) investors forced to look at alternative investment opportunities.
    - EURIBOR methodology, level 3 contribution high.
    - Certain (longer, >10yrs) tenors are targeted when banks issue.
- Dependency imposes cliff risk.
  - Concentrated substitution TLTRO-III funds with market-based funding on large scale could result in higher funding costs.

## 6. For discussion: TLTRO-IV



#### A. Funding/structural:

- Longer-term operations to remain a regular ECB instrument from banks perspective, in order to avoid/manage liquidity cliff effects?
  - Long, flexible maturity to allow a longterm backstop, while banks can switch to market-based at opportune moments.
- Discount-scheme will either disappear, or first make way for a new incentive postpandemic?

#### **B. Opportunistic:**

- Opportunistic TLTRO users will be disincentivised when DFR and hard to reprice retail deposits return to normal levels.
- Supervisory angle: not extending leverage ratio exemption for CB deposits, will push out the banks that have constraints in this metric?

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