

Box 3

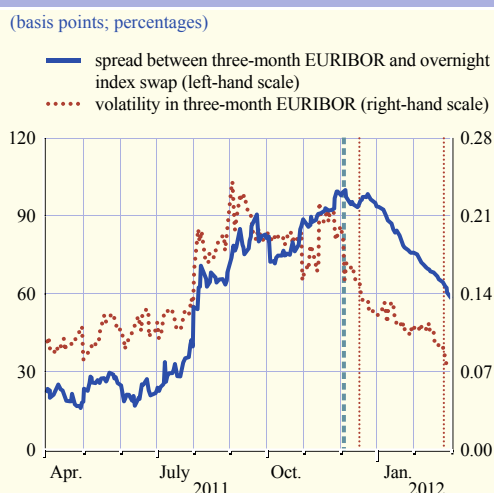
**IMPACT OF THE TWO THREE-YEAR LONGER-TERM REFINANCING OPERATIONS**

The intensification of the stress in sovereign debt markets in the second half of 2011 in the presence of high levels of uncertainty increasingly hampered euro area banks' access to market-based funding. Such impairment risked curtailing lending by credit institutions to euro area households and non-financial corporations. Chart A shows the increased tensions in euro area money markets as of July 2011, as reflected in higher levels of money market volatility and increases in credit risk premia.

To help to forestall such curtailment of credit and ensure that the ECB's monetary policy continues to be transmitted effectively to the real economy, and thereby safeguard price stability in the euro area, the Governing Council of the ECB decided on 8 December 2011 to implement additional non-standard monetary policy measures. The agreed package of measures included two longer-term refinancing operations (LTROs) with a maturity of three years and the option of early repayment.

The first such operation, which took place on 21 December 2011, provided €489.2 billion to 523 credit institutions. This included €45.7 billion transferred from the 12-month LTRO allotted in October 2011 and resulted in a net liquidity injection of €210.0 billion in that week. The second operation took place on 29 February 2012 and saw the allotment of €529.5 billion to 800 credit institutions, in addition to the €6.5 billion allotted in the regular three-month LTRO on that date. When the €29.5 billion allotted in the weekly main refinancing operation is also taken into account, the Eurosystem provided €565.5 billion in these three liquidity-providing operations. This should be seen in the context of the operations maturing in that week, which had a total value of €254.9 billion.

**Chart A A euro area money market spread and volatility**



Sources: ECB, Bloomberg and Thomson Reuters.  
Notes: The vertical green line denotes the announcement on 8 December 2011 of the two three-year LTROs. The two vertical red lines mark the allotment of the two LTROs on 21 December 2011 and 29 February 2012 respectively.

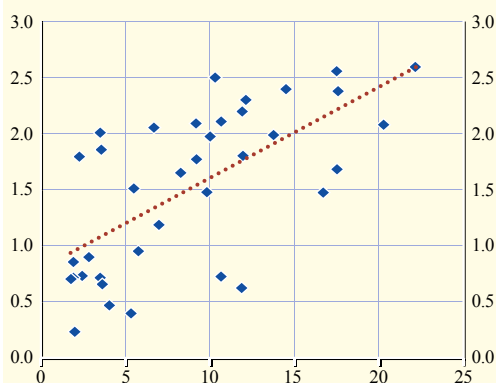
Analysis, combined with anecdotal information provided by banks, suggests that funding considerations played a major role in banks' bidding behaviour in the three-year LTROs.<sup>1</sup> Chart B shows a positive relationship between spreads on bank bonds at issuance (considering both secured and unsecured bonds) and the amounts bid by banks in both three-year LTROs as a percentage of their total assets. However, a substantial number of banks bidding in the three-year LTROs did not issue debt securities in 2011. The chart suggests that even if a bank had been able to obtain longer-term funds in the bond market, it could still have had a strong incentive to borrow from the Eurosystem owing to the lower cost involved. At the same time, these financing conditions render banks' investment and lending opportunities more attractive. This supports the Governing Council's view that these measures will help to remove impediments to the accessing of finance by the real economy.

By improving funding conditions for banks, the ECB may have avoided the disorderly shedding of assets, which would have placed certain financial market sectors under pressure. The three-year LTROs may also have helped to contain spillovers from the sovereign debt crisis to credit and broader financial markets. Moreover, they have improved market sentiment for a broad range of assets and helped to gradually reopen some previously closed market sectors. Chart C illustrates the general narrowing of credit risk premia in debt markets, as measured by spreads for credit default swaps (CDSs), after the LTROs. However, this also needs to be seen in the context of fiscal consolidation in the euro area and recent signs of economic stabilisation.

<sup>1</sup> For analysis of the first operation, see Box 4, entitled "The impact of the first three-year longer-term refinancing operation", *Monthly Bulletin*, ECB, January 2012.

**Chart B Banks' risk premia and bidding behaviour (for banks with market access in 2011)**

y-axis: spreads over mid-swap rates at issuance for long-term debt in 2011 in percentage points  
x-axis: amounts bid in both three-year LTROs as a percentage of total assets

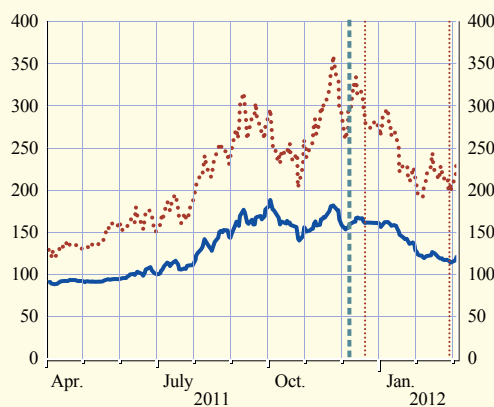


Sources: ECB, Fitch Ratings and DCM Dealogic.

**Chart C Credit default swap spreads for financial and non-financial corporations**

(basis points)

— iTraxx Europe Non-Financial CDS spread  
..... iTraxx Europe Senior Financials CDS spread



Sources: JP Morgan and ECB calculations.  
Notes: The vertical green line denotes the announcement on 8 December 2011 of the two three-year LTROs. The two vertical red lines mark the allotment of the two LTROs on 21 December 2011 and 29 February 2012 respectively. The credit default swap spreads are on five-year on-the-run securities.

It may take several months for the full supportive impact on banks' lending to households and non-financial corporations to become visible in the monetary data. Thus, money and credit growth may remain subdued for some time, before strengthening as a result of these three-year LTROs (albeit recent data on money and credit growth also need to be seen in the context of the current subdued economic activity).

The ECB has at its disposal all of the means necessary to ensure that the conduct of its monetary policy leads to price stability in the euro area. Moreover, in order to manage the implications, in terms of risk, stemming from the corresponding expansion of its balance sheet, the Eurosystem continually reviews the eligibility of collateral and its risk control framework. Furthermore, the application of conservative risk control measures, such as haircuts, in all monetary policy operations ensures that the financial position of the Eurosystem remains sound.