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"Big Bertha" and its effectiveness

Author: Christian Hornberg, phone +49 (0) 69 7431-3770, research@KfW.de

In the coming days, banks will for the first time repay funds borrowed under the ECB's extraordinary three-year tenders, the so-called "Big Bertha". The ECB has achieved its main goal of providing banks with greater liquidity. However, the three-year tenders had only limited direct impact on new lending in the reforming countries. Given the recession, however, this was not surprising. The numerous dreaded side effects did not set in.

What was the actual volume of the ECB's three-year tenders?

The ECB carried out two three-year *Long-term Refinancing Operations* (LTROs), one on 21st December 2011, the other on 29th February 2012. Under the first tender the banks received EUR 489 billion, under the second one EUR 529 billion. After deduction of the one-year LTRO that had matured in the meantime, the volume of LTRO accounts receivable in the ECB balance sheet increased between December 2011 and March 2012 by a net **EUR 731 billion.** This volume is the closest estimate of the medium-term liquidity impact.

As a result of additional maturing short-term transactions, this amount dropped temporarily to the approximately EUR 500 billion that was often mentioned in the media, but climbed to around EUR 630 billion again by June 2012.

Did the three-year tenders stimulate lending?

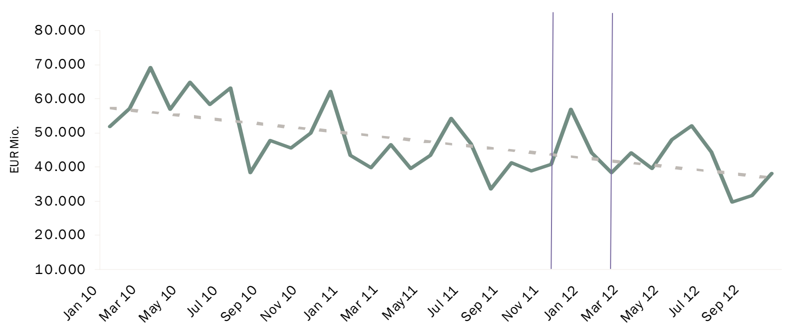
The lion's share of funds was transferred to Spanish and Italian banks. We will therefore take a closer look at these two markets in particular.

At least in **Spain**, after the two three-year tenders new lending operations rose above the typical seasonal upswing. In particular after the second tender, the recovery was stronger than could be seasonally expected and was significantly above the trend (Chart 1). As this was also the period during which a recovery on the Spanish government bond markets had set in, at least some of the LTRO funds actually found their way into the credit markets and thus fulfilled part of their mission.

Italian data, on the other hand, show no indications of a revival of new lending from the LTROs, on the contrary: new lending, completely unimpressed by the two LTROs, contracted very fast since the end of 2011. However, the Italian banks were not affected by the same far-reaching funding difficulties (no previous real estate bubble in the balance sheets), so that lending there was not limited by funding but rather by the weak economy.

Overall, the **direct, short-term impact** on the credit market is weak, but nothing else was to be expected in view of the severe recession in the reforming countries.

Chart 1: New lending by Spanish banks to companies and self-employed individuals



Source: Banca de España, own calculations.

How strongly did the three-year tenders contribute to restoring confidence on the markets for bank bonds?

The premiums for credit default swaps for five-year bank bonds from large European banks fell considerably after the three-year tenders (Chart 2). It was only when the crisis flared up again in early summer of 2012 that they rose again as the issue of a *lender of last resort* for the Euro area was not yet conclusively settled.

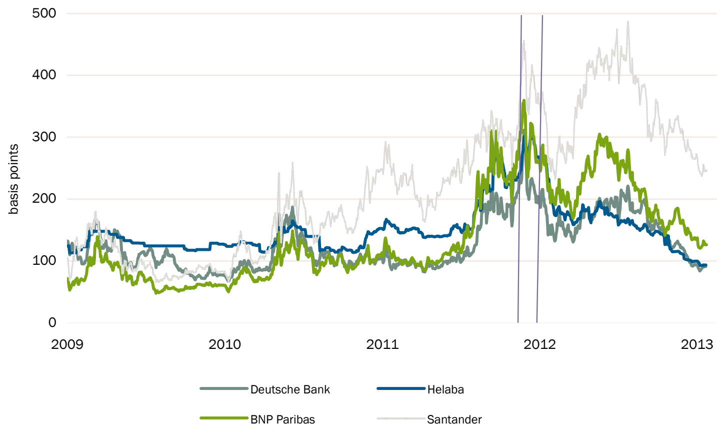
Overall, funding conditions for banks improved noticeably as a result of the two tenders. This applies even more to the short-term interbank market. On the day of announcement the 3-month EURIBOR fell from 1.472 to 1.430 %, dropping further to 0.948 % by 2nd March 2012 (the day after settlement of the second three-year tender).

Thus, the tenders achieved the goal of stabilising the money market and bank funding.

How intensively did the commercial banks use the three-year tenders to hoard liquidity on their accounts with the ECB?

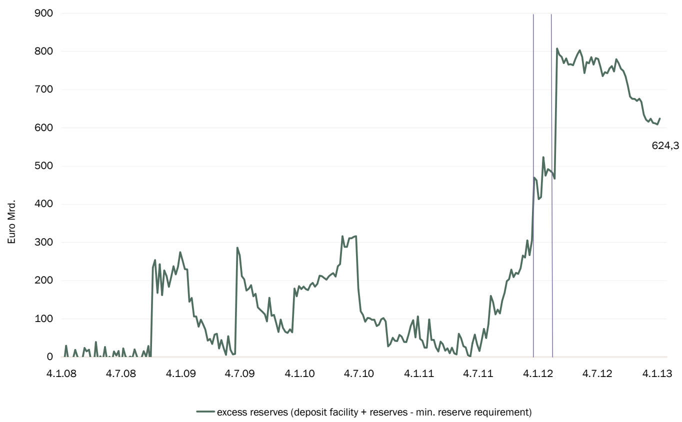
Chart 3 shows the development of the excess reserves (banks' deposits with the ECB less minimum reserve) over the last years. Immediately after the two tenders, the excess reserves rose by around EUR 165 billion (after the first) and by some EUR 340 billion (after the second) and remained on a historic "high plateau" for a long time. At an estimated net liquidity injection into the banking system of a good EUR 630 billion, the banks kept

Chart 2: CDS spreads of large European Banks (in basis points)



Source: Bloomberg.

Chart 3: Banks' excess reserves with the ECB (EUR billions)



Source: Bloomberg, own calculations.

roughly 80 % on average on their accounts in the first months after the two tenders in order to protect themselves against possible liquidity bottlenecks – such as the withdrawal of deposits by anxious customers. Since then the reserves have declined, first slowly and, since the end of July 2012, somewhat faster. As a result, increasingly more liquidity is now available to the real economy.

The banks' massive, precautionary liquidity holdings are one of the reasons inflation, contrary to the predictions of many pundits, has not accelerated.

How strongly have the European banks' holdings of government bonds increased as a result of the three-year tenders?

Between November 2011 and June 2012, by EUR 206 billion, from EUR 1,381 billion to EUR 1,587 billion, of which EUR 140 billion immediately after the two tender operations.

However, this is probably due not only to direct purchases of government bonds but, to a lesser degree, also to write-ups after the government bond markets calmed down.■