Additional ECB easing measures involve longer-term risks

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15 JANUARY 2021
(ORIGINAL JAPANESE VERSION RELEASED ON 25 DECEMBER 2020)

The Governing Council of the European Central Bank (ECB) announced the implementation of extensive, additional easing measures at its latest policy meeting on the 10 December. The pandemic emergency purchase program (PEPP) was expanded and extended. The advantageous interest rates offered under its targeted long-term financing operations (TLTRO-III) were extended with additional operations (Table 1).

The ECB President Christine Lagarde stated that the monetary policy measures taken will contribute to preserving favourable financing conditions over the pandemic period. ECB is now taking the necessary measures to maintain low interest rates and avoid credit crunch in the worsening business conditions due the second wave of the pandemic (The risk of the no-trade-deal with the UK is also thought to be one of the backgrounds of this decision, but agreement was reached on 24 December).

However, it is unclear how the extension of the currently implemented TLTRO-III easing and additional measures will ensure finance availability. The TLTRO-III take-up in December was approximately 50 billion EUR, which was a small amount compared to June (1.3 trillion EUR) and September (175 billion EUR). According to the ECB Bank lending survey in October, the percentage of banks citing a precautionary motive to participate in TLTRO has fallen through the year. Precautionary funding by banks in preparation for the financial market disruption has peaked out (Figure 1). It is likely that some banks have already used most of their funding, and do not have the means to apply for additional funds.

For banks whose eligible net lending is higher than their lending benchmark, the interest rate for existing TLTRO-IIIs will be -0.5% less than the deposit facility rate, which is currently 0%. However, under the prolonged economic disruption from COVID-19, it is likely that some banks might be more cautious about expanding the use of TLTRO-III over balancing profit and credit risk.

Furthermore, there are concerns about excessive asset prices appreciation following the ECB’s extension and expansion of large asset purchase programmes, such as PEPP. However, at this point, there is no prospect of imminent monetary tightening. The baseline inflation rate for 2023 was lowered to 1.4% YoY in the latest ECB staff December macroeconomic projections.

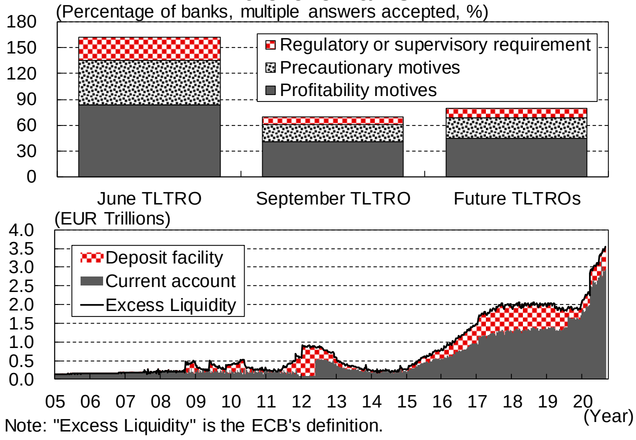
Looking ahead, the ECB is likely to face more difficulties in controlling the inflation rate while minimizing the negative side-effects from prolonged massive monetary easing. It will be important to keep an eye on the ECB's balanced approach to maintain the sound financial market.

Table 1: Details of ECB Governing Council December Meeting

	Existing Measures	December Changes
PEPP	A total of 1,350 billion EUR of additional net purchases until at least the end of June 2021. Available until the Governing Council judges that the coronavirus crisis phase is over.	Additional net purchases to a total of 1,850 billion EUR until at least the end of March 2022.
Change in TLTRO-III	For banks with outstanding loans from 1 March 2020 until 31 March 2020, a reduction of 50bp in deposit facility interest and loan interest rates by June 2021 (-1.00%). For other banks, a reduction of 50bps for main refinancing and lending interest rates until June 2021(-0.50%). Eliminate bid limits, and total amount bidding (aggregate borrowing limit increase to 50% of outstanding eligible loans)	■The current interest loans application period is extended to June 2022 and the addtional operations will be conducted in June, September and December 2021. ■Banks that have sustain their loans current level from 1 October 2020 to 3 December 2021 can change to favourable interest application terms. ■Borrowing limit amount is raised to 55% of their stock of eligible loans by June 2022.
PELTROs	Implemented once a month (7 times total) from 21 May until the 3 December 2020	4 additional times in March, June, September and December 2021
Collateral easing measures	Additional eligible collateral, such as Greece's sovereign bonds. If government bonds of BBB- stay above BB after downgrade on 7 April, they will be recognised as eligible collateral. Reduction of valuation haircuts by 20%	The following measures application period will be extended to June 2022.

Source: ECB, MUFG Bank Economic Research Office

Chart 1:TLTRO-III Usage Motives and Liquidity in Eurozone Banks



Note: "Excess Liquidity" is the ECB's definition.
Source: ECB, MUFG Bank Economic Research Office

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