

European Union: BCE / LTRO : what's that ?

Series: Governments submit to "Too Big to Fail" banks (part 5)

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In 2010 institutional investors (including banks) and hedge funds attacked Greece, the weak link in the European chain of debt, before turning their attention to Ireland, Portugal, Spain and Italy. In so doing, they made juicy profits by forcing these countries to increase their interest-rate on their bond issues in order to refinance their debts. Among investors, private banks made the biggest profits, by directly obtaining funds from the ECB at 1%, while at the same time making quarterly loans at 4% or 5%. As far as securities are concerned, they only agreed to buy Irish and Portuguese ten-year bonds if the interest-rate rose to 10%.

When attacking the weak links the institutional investors (among whom banks are a central element) were sure that the EU and the ECB would be forced to assist, in one way or another, the States that were the victims of speculation by lending them the funds necessary to continue debt repayments. They were quite right; loans were made or granted to the countries in difficulty. The loan conditions imposed by the Troika (the ECB, the European Commission and the IMF) aimed at producing brutal austerity measures, cuts in wages and pensions, and public-sector redundancies.

Despite the help of the ECB, in June 2011 the European banks entered a highly critical phase. Their situation was almost as serious as on 15 September 2008, after the failure of Lehman Brothers. Many of them were threatened with asphyxia because their massive needs for short-term financing (several hundred billion dollars) were no longer being met by the American Money Market Funds, who felt that the situation of the European banks was becoming more and more risky. [\[1\]](#)

The banks were in danger of being unable to honour their debts. That is when the ECB, following an emergency European summit held on 21 July 2011 to deal with the prospect of a series of bank failures, resumed massive purchasing of Greek, Portuguese, Irish, Italian and Spanish public-debt securities from the banks (on top of the aforementioned loans) in order to provide cash flow and relieve them of a part of the securities they had greedily purchased during the preceding period. Interest-rates too were cut on debts of countries in the periphery, to no avail; bank share values continued to crumble and interest-rates for countries like Italy and Spain remained high. The decisive action that kept the European banks afloat was the extension by the ECB, beginning in September 2011 and in consultation with the Fed, the Bank of England and the Swiss National Bank, of an unlimited line of credit. Banks that were starved for dollars and euros were put on life support. They began to breathe again; but the treatment was insufficient. Their share prices continued to plunge. Between 1 January and 21 October, 2011, the price of shares in France's BNP-Paribas dropped by 33.3% and in Deutsche Bank 28.8%; Barclays dropped 30.5% and Credit Suisse 36.7%, and Société Générale plummeted 52.8%. The ECB was forced to deploy the heavy artillery.

What is an LTRO ?

An LTRO (Long-Term Refinancing Operation), a long-term loan mechanism for banks, was created. Between December 2011 and February 2012, the ECB lent over €1 trillion (that is, €1,000 billion) to more than 800 banks for a period of 3 years at an interest-rate of 1% (at a time when inflation was about 2%). In fact, the gift to banks was even more generous than is suggested by an interest-rate of

only 1% (already very advantageous). Why? For two simple reasons. First, the interest is not due until the repayment date of the loan. If a bank borrows over three years for the full period it has no repayments to make, interest or capital, until the end of the three year period. And secondly, this rate has since been lowered several times, to 0.15% in June 2014 and to 0.05% in September 2014 [2].

Consider a bank such as Dexia, which borrowed more than €20 billion from the ECB over three years at the beginning of 2012: It will not be asked for repayment until the beginning of 2015, when it will also be called upon to repay the totality of the interest, which will be calculated as follows: A 1% interest-rate until July 2012, 0.75% for the period from July 2012 to May 2013, 0.50% from May 2013 to November 2013, 0.25% from November 2013, 0.15% from June 2014 to September 2014, and 0.05% interest starting in September 2014. [3] It is clear that when having to repay, Dexia, or the Italian bank which has drawn €24 billion on the same terms, Intesa Sanpaolo (ISP.MI), will be unable to repay unless they draw out a new loan more or less equivalent to the previous loan. So who are they going to borrow from to repay the loan? The ECB, of course! Its president Mario Draghi has announced that at the end of the 3 years, the ECB will grant new loans, without volume limitation, for periods of six months, or more (Targeted Long Term Refinancing Operations - TLTRO). [4]

Initially, the ECB stated that the volume of new long-term loans would reach \$400 billion. We shall be able to take stock of the use that is made of these loans in February or March 2015 after the various TLTRO lines of credit have been granted. The TLTRO program began in September 2014 when a first liquidity facility of 82.6 billion euros was granted. A second liquidity facility will be made available in December 2014, which will coincide with the first repayment deadline to be met by banks that used the LTRO facility in December 2011. We emphasize that some of the banks that had used the LTRO in December 2011 chose to repay the ECB in advance as evidence of good health. The most fragile banks still owe the first LTRO loans. So the deadlines in December 2014 (the first LTRO repayment) and February 2015 (second LTRO repayment) are important.

Imagine what would have happened if Dexia, and many other banks that were in trouble, had not had access to ECB loans; they would have simply switched off the lights and done a bunk. In fact, if they found lenders (which would not have been easy given the amounts needed), the banks would have had to pay more than 8% interest, and pay it regularly. Not only does the ECB assist private banks' finances by buying their *covered bonds* [5] and accepting structured products as collateral for the new loans that it grants to them, but the private banks also enjoy a monopoly in government financing. In the coming months, the ECB will be purchasing very large quantities of structured products (produced by the banks themselves and known as ABS).

The result of the double LTRO / TLTRO operation is clear: **protecting the interests of the victims of the crisis would have required other choices, such as, closing down failing banks while protecting savers' deposits, creating a bad bank for toxic assets at the charge of the major shareholders (without paying them compensation) and integrate the healthy part into a genuinely public body. The banking sector should have been socialised and given a genuine public service mission.**

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P.S.

* <http://cadtm.org/BCE-LTRO-what-s-that>

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Footnotes

[1] In August 2011, a CADTM series entitled 'In the eye of the storm: the debt crisis in the European Union', CADTM, 14 June, 2012, (<http://cadtm.org/In-the-eye-of-the-storm-the-debt>), described this situation, at a time when very few financial commentators dared to speak of it: They (the European banks) financed, and still finance, their loans to European States and businesses through the United States' Money Market Funds. Since it took fright of what was happening in Europe from June 2011, this source of low-interest-rate financing has almost dried up, precipitating, principally, the major French banks into a stock-market plummet, which increased the pressure on the ECB to redeem their shares and thus provide them with money. To summarise, we have another demonstration of the interaction between the economies of the United States and of the EU. Hence the constant contact between Barack Obama, Angela Merkel, Nicolas Sarkozy, the ECB, the IMF ... and big bankers Goldman Sachs, BNP Paribas, Deutsche Bank... A breakdown in the access to dollars enjoyed by European banks can cause a very serious crisis on the old continent, and difficulties of European banks to pay US lenders may precipitate Wall Street into new crises.

A study by the bank Natixis confirms the distress experienced by French banks during the summer of 2011: Flash Economie, 'Les banques françaises dans la tourmente des marchés monétaires' ('The French Banks in turmoil in the money markets'), October 29, 2012, reads: 'De juin à novembre 2011, les fonds monétaires américains ont subitement retiré la plus grande part de leurs financements aux banques françaises. (...) C'est jusqu'à 140 Mds USD de financements à court terme qui ont fait défaut aux Banques françaises à fin novembre 2011, sans qu'aucune ne soit épargnée.' ('From June to November 2011, U.S. money market funds suddenly withdrew most of their funding for French banks. (...) French banks were short of close on \$140 billion of short-term financing at the end of November 2011, with none of them spared.'). <http://cib.natixis.com/flushdoc.aspx?id=66654> (in French). This shut-down also affected most other European banks, as is also shown in this study by Natixis.

[2] See Eric Toussaint *To the Bankers, He's "Super Mario 2.0 Draghi"* 8 September

[3] See on the ECB website: 'In this longer-term refinancing operation, the rate at which all bids are satisfied is indexed to the average minimum bid rate in the main refinancing operations over the life of the operation', <http://sdw.ecb.europa.eu/servlet/desis?node=100000133>

[4] See Eric Toussaint *To the Bankers, He's "Super Mario 2.0 Draghi"* 8 September

[5] See Eric Toussaint: 'Central Banks lend massively to the banking sector' 23 August 2014, <http://cadtm.org/Central-Banks-lend-massively-to>, which says: this is a very important assistance

by the ECB to the private banks, which, as we have seen, had serious difficulty to find funding on the financial markets. This assistance has quite simply been ignored by the media. Since the beginning of the crisis the ECB has purchased €76 billion of covered bonds, €22 billion on the primary market and €54 billion on the secondary market, including bonds rated as bad as BBB-, which expresses lack of confidence in the issuers. On the 18 March 2014 the ECB held €52 billion's worth of covered bonds. This is a very large proportion of the total amount of the covered bonds the banks have issued. In 2013 the amount was €166 billion, 50% down in two years