Knowing your TLTROs from your PELTROs

By Andy Hill, ICMA [5/1/2020]

At its press conference following yesterday's meeting of the general Council, the ECB announced how it is modifying the current TLTRO programme, and introducing a new PELTRO programme. Another acronym to add to the long list of ECB toolkits. But what does this actually mean?

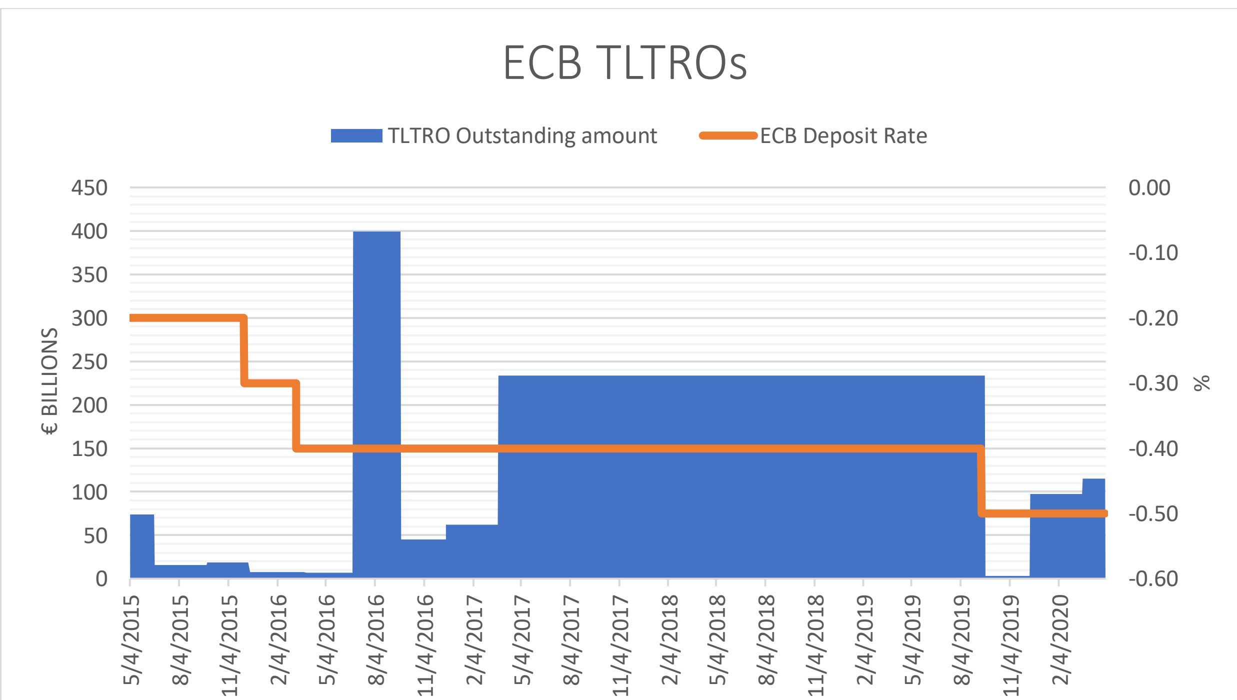
Targeted Long Term Refinancing Operations were first introduced in 2014. This is effectively a series of long-term repo operations with banks (3 years) which provide very cheap funding (at or even below the ECB Deposit rate) against eligible collateral, and is directly linked to the size of the bank's underlying loan portfolio with respect to non-financial corporates and households. The repo rate is tiered based on the average size of lending/take-up. The 3rd TLTRO programme was rolled out in September 2019 (as part of the re-commencement of QE).

Unlike the CSPP, which in effect only provides slightly cheaper borrowing for corporates who already have no problems accessing cheap funding through the bond markets, it is argued that the TLTROs help to channel funding to SMEs ('the real economy') who otherwise would not have access to capital markets.

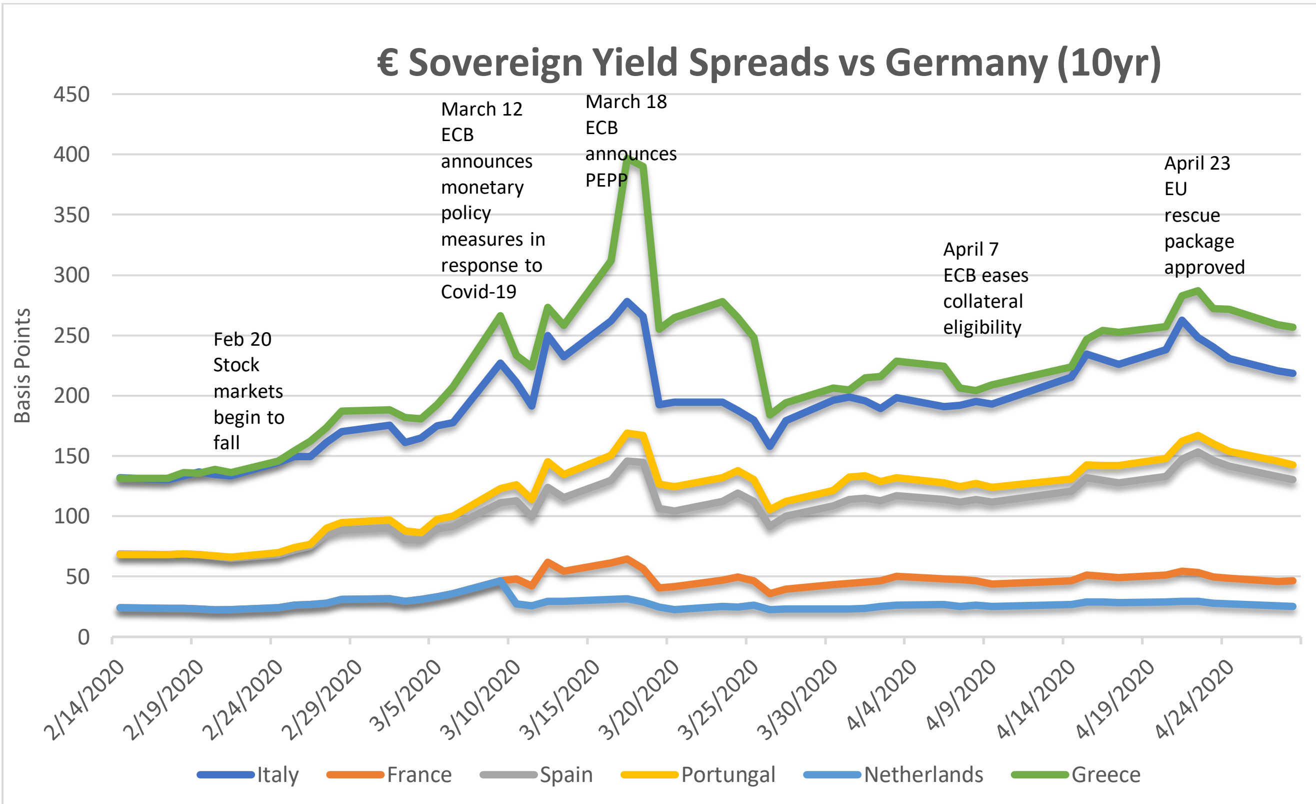
Yesterday the ECB announced that from June it was cutting the lowest rate on TLTRO III from 25bp below the Depo Rate to 50bp (effectively offering banks a window to get paid 1% for borrowing money based on the size of its loan portfolio). This extremely cheap funding should be a strong incentive for take-up of the programme.

The newly announced Pandemic Emergency Long Term Refinancing Operations appear to be a slightly different animal, and more akin to the LTROs introduced in 2010-11 during the eurozone sovereign crisis. These effectively provide banks with cheap 1-and- a-bit-year repo funding (until September 2021) at a rate of -0.25%. This seems to be not so much targeted at stimulating lending into the 'real economy' but more so at offering support for the short-term euro sovereign funding. Essentially it provides a 'cash-and-carry' arbitrage for banks who can buy short-dated t-bills and bonds that yield above -0.25% (so essentially the lower credit periphery issuers) and fund them cheaply through the PELTRO.

While the PELTROs should help to support short-term financing for the peripheries, it does not quite deliver when it comes to settling nerves about longer-term borrowing costs and sustainability, where an expansion of the PEPP would have been helpful. But we should not forget that the ECB potentially still has the OMT (Outright Monetary Transactions) 'bazooka' in its arsenal, which allows it to do whatever it takes to support the eurozone. While it is will be reluctant to reach for it, and activating it may not that straightforward, the longer the EU dawdles on its projected Recovery Fund, the more necessary it may become.



Source: ICMA analysis using Bloomberg & ECB data



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Note that these views are those of the author and do not necessarily reflect those of ICMA