

MACROCOSM

## Europe's New Lenders of Last Resort

Tuesday, November 29, 2011

Lorcan Roche Kelly

### Three more national central banks now engage in Emergency Liquidity Assistance.

When we last wrote about the lender of last resort role of the individual national central banks within the Eurosystem (see "[Understanding ELA: Emergency Liquidity Assistance](#)" July 15, 2011) the only national central bank that was making use of ELA was the [Central Bank of Ireland](#). Now the most recent available data show that the [Greek](#), [Belgian](#) and [Cypriot](#) (see "[Europe, Living on the Edge](#)" August 1, 2011) central banks are all using the facility.

The ELA currently issued by the four central banks comes in two flavors.

- For the Irish and Belgian central banks, the ELA is new money for the banking system. This means that the ELA issued to the national banking system is in addition to the ECB liquidity being used via normal refinancing operations.
- In the case of the Greek and Cypriot central banks, the ELA is being used to replace ECB liquidity (please see the chart below).

This means that through the use of ELA at the national central bank level, the ECB is able to reduce its exposure to risky countries like Greece and

#### Update to strategic view

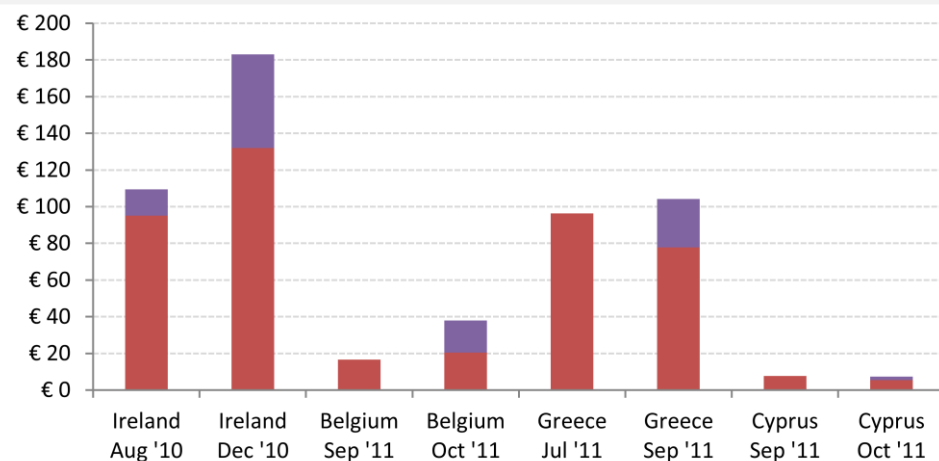
##### ECB, EUROPE MACRO:

The use of ELA is spreading among Euro area central banks. Short term, it provides a very important backstop for banking systems that no longer have the collateral to access ECB liquidity. However, it does become a contingent liability of national governments who themselves are already under funding pressure.

[\[Strategy Dashboard home\]](#)

**Liquidity sources before and after first major use of ELA** EUR billions

■ Normal ECB liquidity ■ ELA



Source: Central banks, TrendMacro calculations

Cyprus. Unfortunately for Greek and Cypriot banks, this substitution of ELA for ECB liquidity means that ELA has been little more than a lifeline preserving the *status quo* -- not a net liquidity increment for the banks.

- It is not clear yet why the ECB would be reducing its exposure to Greek banks. We do not know if this reflects an emerging problem in collateral value or availability, a prudential risk preference, a political maneuver, or something else. But if the ECB continues to unwind its refinancing exposure to Greek banks, then the levels of ELA needed from the Greek central bank will be increased -- first to substitute for any ECB unwinds, and then further due to any [additional bank funding pressure](#).
- This is a potentially important development for Greece's stability, as ELA is a contingent liability for the Greek government, whereas ECB funding is a Eurosystem liability.

We will continue to monitor this situation in the coming months -- and look for signs of ELA use by other central banks. ELA is a lifeline -- it is a key component of Europe's safety net in the present crisis. Without it, bank runs and messy bank failures would have already added to Europe's considerable woes. Yes, it's a bad thing that ELA must be deployed at all. But yes, it's a good thing that it is there to be deployed.

---

### Bottom line

The use of ELA is spreading among Euro area central banks. Short term, it provides a very important backstop for banking systems that no longer have the collateral to access ECB liquidity. However, it does become a contingent liability of national governments who themselves are already under funding pressure. ▶

---

### Contact TrendMacro

On the web at  
[trendmacro.com](http://trendmacro.com)

Follow us on Twitter at  
[twitter.com/TweetMacro](https://twitter.com/TweetMacro)

Donald Luskin  
Menlo Park CA  
650 429 2112  
[don@trendmacro.com](mailto:don@trendmacro.com)

Thomas Demas  
Charlotte NC  
704 552 3625  
[tdemas@trendmacro.com](mailto:tdemas@trendmacro.com)

Lorcan Roche Kelly  
Sixmilebridge Ireland  
212 537 9067  
[lorcan@trendmacro.com](mailto:lorcan@trendmacro.com)

John Clinton  
Charlotte NC  
704 552 3629  
[jclinton@trendmacro.com](mailto:jclinton@trendmacro.com)

[\[About us\]](#)