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TRENDMACRO LIVE!

On the January ECB Rate Decision

Thursday, January 12, 2012

Lorcan Roche Kelly

The ECB has done enough for the moment -- and maybe enough for the banks.

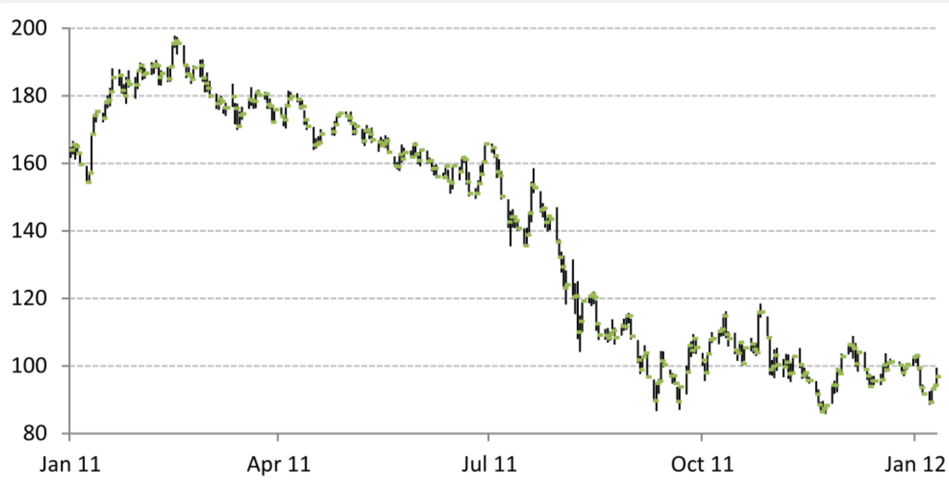
Expectations were low for today's ECB meeting and President Mario Draghi did not disappoint.

- All interest rates remain unchanged -- the main refinancing rate stays at 1%.
- There were no new liquidity measures announced.

But Draghi did point to some developments that suggest an improvement of the situation for long-suffering banks in Europe (please see the chart below).

- He confirmed that December's 3-year Longer Term Refinancing Operation (LTRO) was accessed by banks that had debt roll-overs coming in Q1 2012 -- which we highlighted at the time (see "Europe's Wall of Liquidity" December 21, 2011).
- He also said that euro area banks will have much more eligible collateral -- available under the new collateral rules introduced in December (see "On the ECB Monetary Policy Decisions"

Dow Jones STOXX European Financial Sector Index



Source: Bloomberg

Update to strategic view

ECB, EUROPE FINANCIAL STOCKS: No change in interest rates at the ECB, with the policy of abundant liquidity remaining, and expectations for the next LTRO high. Mario Draghi confirmed that interbank market conditions are starting to improve. We reiterate that this is likely the moment where euro area banks turn the corner.

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December 8, 2011) -- in time for the next 3-year LTRO at the end of February.

- Accordingly, he predicts the next 3-year LTRO will be "substantial." This, again, is in line with our analysis (see "Le Collateral" January 6, 2012 and "Cash for Gold!" January 11, 2012).
- Draghi said that while the interbank market in Europe is still strained, some banks are now able to sell unsecured debt into the market.

This nascent improvement of the inter-bank market -- coupled with the ECB's clear determination to provide any and all liquidity that banks could wish for -- means that European financial stocks could finally be turning a corner, as we mentioned yesterday (again, see "Cash for Gold!").

- The banks need three things to improve their situation -- capital, liquidity and time. The ECB is providing liquidity -- as much of it as the banks want -- and time -- at least 3 years. Capital remains the one thing the ECB cannot directly give to the banks.
- However, if capital is the only constraint, then it should be relatively easy for investors to select banks in the euro area based on their current capital levels.
- Banks that have raised capital in the last year -- including Unicredit's very messy recent raise -- should be in a much more robust position now than the market is giving them credit for.

Bottom line

No change in interest rates at the ECB, with the policy of abundant liquidity remaining, and expectations for the next LTRO high. Mario Draghi confirmed that interbank market conditions are starting to improve. We reiterate that this is likely the moment where euro area banks turn the corner.

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