Trend Macrolytics, LLC
Donald Luskin, Chief Investment Officer
Thomas Demas, Managing Director
Lorcan Roche Kelly, Chief Europe Strategist

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# On The First LTRO Payback

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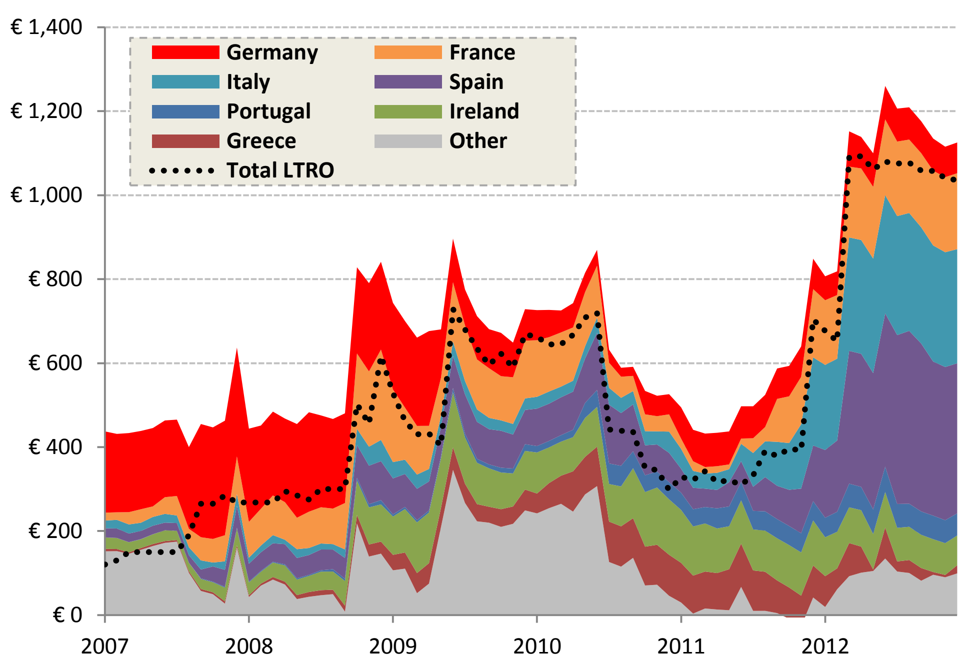
**Lorcan Roche Kelly**

**Banks are set to repay €137bn of LTRO. Don't worry -- this is not ECB tightening.**

This morning the European Central Bank announced that €137 billion of the December 2011 3-year LTRO (see "Europe's Wall of Liquidity" December 21, 2011) would be repaid by 278 banks at the next tender operation on January 30. Under the terms of the LTRO, this is first opportunity for banks to opt out and return some or all of the money initially committed for three years.

- Today's announced repayment accounts for 28% of the €489 billion received in the December 2011 3-year operation.
- But 278 of the 523 original bidders -- over 50% -- are paying back some of the money they received at the tender a year ago.
- This is only the first repayment of the first LTRO. Banks can repay more of the December 2011 LTRO at any weekly financing operation from here, once they give a week's notice to their national central bank. On February 27 banks can start making repayments

**ECB refinancing operations, by country** EUR billions




Source: Bloomberg, TrendMacro calculations

**Update to strategic view**

**EUROPE MACRO, ECB, EUROPE FINANCIAL STOCKS:** Today's announcement that euro area banks will repay €137 billion of the first 3-year LTRO should not be viewed as tightening by the ECB, even if it leads to a reduction in the size of the ECB's balance sheet. If a bank repays the 3-year money, it can still access other ECB operations. The ECB's stance is still very accommodative, giving banks access to liquidity limited only by collateral. It is a change in that stance that would matter to the banks and the euro area economy. That change is still a long way off.

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on the second -- and slightly larger -- LTRO that was conducted in February 2012.

Banks may have felt under pressure to make some repayment at this time just to show they could -- a public relations exercise designed to show their strengthened funding position. To be clear, this strengthened position is not an illusion -- the STOXX euro area bank index is up 74% from the July 2012 low (see "On Draghi in London" July 26, 2012) -- and higher today, within basis points of new highs, on today's repayment news. Besides, the opportunity cost for an institution repaying is quite low.

- The €137 billion to be returned represents 12% of overall current liquidity provided by the ECB (see the chart on the previous page).
- The ECB continues to run its liquidity operations on a fixed-rate full-allocation basis. If a bank repays money at the tender operation on January 30, it can borrow from the 3-month LTRO that is being allotted that same day to maintain its liquidity position (in size, if not in duration of commitment).
- The number that matters for each bank's funding position is the *net change* in ECB liquidity after the operations next week.

Whatever the net change in overall borrowing -- and the commensurate decrease in the size of the ECB's balance sheet -- turns out to be, it should not be viewed as tightening by the ECB.

- From a monetary policy standpoint, even a net drop in bank participation is not that important, because the ECB will not have changed its stance at all.
- That stance is built not on a particular level of lending to banks, but rather on optionality -- on the availability of funding should banks require it, unlimited except by the requirement for collateral. The ECB currently offers to banks -- and will continue to offer for the foreseeable future -- all of the liquidity they want using the weekly main refinancing operations (MRO) and shorter long-term refinancing operations.

The size of the ECB's balance sheet will probably start to shrink over the coming months as LTRO repayments are made. But, it is not the size of the balance sheet that matters -- it is the policy stance of the ECB. There is no sign of that changing yet.

## Bottom line

Today's announcement that euro area banks will repay €137 billion of the first 3-year LTRO should not be viewed as tightening by the ECB, even if it leads to a reduction in the size of the ECB's balance sheet. If a bank repays the 3-year money, it can still access other ECB operations. The ECB's stance is still very accommodative, giving banks access to liquidity limited only by collateral. It is a change in that stance that would matter to the banks and the euro area economy. That change is still a long way off.

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On the web at trendmacro.com

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Donald Luskin
Chicago IL
312 273 6766
don@trendmacro.com

Thomas Demas
Charlotte NC
704 552 3625
tdemas@trendmacro.com

Lorcan Roche Kelly
Sixmilebridge Ireland
212 537 9067
lorcan@trendmacro.com

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