

Recourse to Eurosystem funding by Spanish banks

Ricardo Gimeno and Ana del Río



5 July 2018

During the crisis, euro area banks' recourse to Eurosystem funding facilities was closely related to the severe tensions in the funding markets. However, since the latter part of 2014, Eurosystem refinancing operations have been essentially determined by the implementation of the single monetary policy and the need to reinforce the monetary stimulus by means of non-standard measures. The Spanish banking system currently has a relatively high level of recourse to Eurosystem funding, as a proportion of GDP and in terms of its weight in the banking sector balance sheet, although its share of total Eurosystem funding has fallen since 2014. The long maturities of this funding and the favourable conditions in the financial markets in the more recent period have afforded banks more scope to refinance or repay these debts in an orderly manner.

Introduction

The provision of liquidity to the banking system forms part of the instruments available to monetary policy to achieve its primary objective, which in the case of the European Central Bank (ECB) is to maintain price stability in the medium term. The provision of liquidity, together with the minimum reserve requirements and the standing lending and deposit facilities, make up the operational framework of the common monetary policy.¹ Its main function is to facilitate control of short-term interest rates, manage the system's liquidity position and signal the monetary policy stance, so as to transmit monetary stimulus to the financial conditions of the economy and to agents' spending and financing decisions and, through this channel, to inflation.

Before the financial crisis, the main refinancing operations (MROs) were a key tool in the implementation of monetary policy in the euro area and met most of credit institutions' liquidity needs. Through these weekly refinancing operations, the Eurosystem actively managed the provision of liquidity, facilitating satisfactory control of very short-term interest rates, as the first link in the transmission of monetary policy. In turn, very limited use was made of the standing lending and deposit facilities that allowed banks to obtain and place liquidity, respectively, at any time overnight. The interest rate corridor of these facilities acted as a floor (the deposit facility) and a ceiling (the marginal lending facility) for very short-term interest rates in the interbank market.

The global financial crisis and the sovereign debt crisis in the euro area forced the Eurosystem to make successive changes to the operational framework in order to meet its objectives. Initially, in view of the collapse of the interbank markets, the ECB had to ensure the correct provision and distribution of liquidity, assuming much of the intermediation function that was previously carried out by the market. In this setting, for example, the ECB abandoned the liquidity provision system based on control of the amount supplied and began to fully satisfy the banking system's liquidity demands, introducing the full allotment procedure for regular refinancing operations that continues in force for current tenders.² As the crisis became more prolonged and tensions emerged in the sovereign debt markets, the ECB made further changes to the operational framework to combat banks' refinancing risks and prevent fragmentation of financial conditions between countries. Thus, seeking to ensure uniform transmission of the single monetary policy, the ECB introduced specific long-term refinancing operations (LTROs)³ and limited-amount specific asset purchase programmes.⁴

More recently, since mid-2014, against a backdrop of limited scope for further decreases in policy rates, the ECB again extended its monetary policy instruments to include non-

¹ For more details, see ECB (2011), *The implementation of monetary policy in the euro area, general documentation on Eurosystem monetary policy instruments and procedures*.

² In October 2017, the ECB Governing Council extended the fixed-rate tender procedure with full allotment for regular monetary policy operations, at least until the end of the last reserve maintenance period of 2019.

³ In addition to the 3-month long-term refinancing operations (LTROs), longer term operations were gradually introduced, culminating in 12-month refinancing operations in June 2009. The last 12-month refinancing operation was conducted in October 2011. In December 2011, two 3-year refinancing operations (VLTROs) were announced, conducted in December 2011 and February 2012.

⁴ The covered bond purchase programmes CBPP and CBPP2 were launched in July 2009 and November 2011, respectively. In May 2010 the Securities Markets Programme (SMP) was launched, in response to the sovereign debt crisis and with a view to remedying the monetary policy transmission problems arising from tensions in the securities markets. The liquidity injected through the SMP was sterilised by weekly liquidity absorption operations to prevent it affecting the monetary policy stance.

standard measures, in this case seeking to intensify the monetary stimulus and curb downside inflation risks. These measures included new targeted longer-term refinancing operations (TLTROs), which are described below, and the expanded asset purchase programme (APP).⁵

In consequence, and in comparison with the pre-crisis situation, the funds provided by the Eurosystem to the banking system have increased substantially, and their composition, nature and distribution by country have changed. This article analyses these aspects, together with the changes in banking sector balance sheets, focusing in particular on the case of the Spanish banking system.

Developments in Eurosystem funding: 2007-2018

Eurosystem funding to euro area banks through monetary policy operations amounted to some €760 billion in May 2018, a level that has been very stable since March 2017 (see Chart 1). This figure does not include securities issued by credit institutions and acquired by the Eurosystem through the various covered bond purchase programmes. Nor does it include the emergency liquidity assistance (ELA) that played an important role for various banking systems at certain points in the crisis and on which the Greek banking system still depends.⁶

Funding provided by the Eurosystem is higher than it was before the crisis – 85% higher than in early 2007 – and the composition, nature and characteristics of the funding has also changed. The weekly refinancing operations account for barely 0.2% of the total, compared with more than 70% ten years ago. In addition, as shown in Table 1, in terms of distribution of funding by country, Italy, Spain and Portugal have a relatively higher weight (in relation to the ECB's capital key).⁷ Spanish banks' recourse to Eurosystem funding amounted to almost €170 billion in May 2018, the second highest figure in the euro area after Italy (approximately €250 billion). For both countries this represents a volume close to 15% of GDP and 6% to 7% of the banking sector balance sheet, figures which are slightly lower in the case of Portugal. Considering the 19 euro area member countries, the median value of Eurosystem funding amounts to 4.5% of GDP and 1.4% of bank assets. To understand the reasons behind this, it is necessary to go back to the sovereign debt crisis and, especially, to the implementation of the common monetary policy since mid-2014.

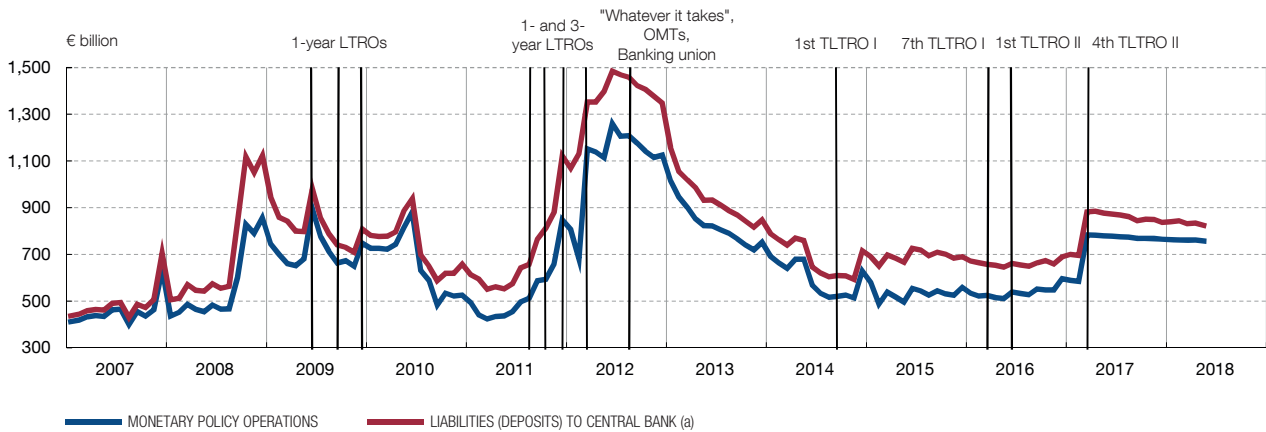
The largest increase in Eurosystem funding occurred during the sovereign debt crisis in 2011 and 2012, when the ECB made its liquidity-providing operations more flexible and launched two 3-year refinancing operations (the VLTROs, conducted in December 2011 and February 2012), which provided the banking system with stable funding, seeking to ensure that the market tensions would not exacerbate the downturn and would not prevent transmission of the common monetary policy (see Chart 1). In mid-2012,

5 See, for instance, ECB, "The transmission of the ECB's recent non-standard monetary policy measures", *Economic Bulletin*, 7/2015.

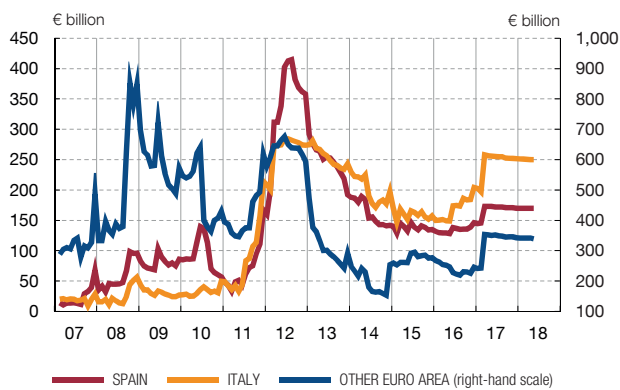
6 Given the different nature and purpose of ELA funding, in this article it is deemed to be excluded from the concept of Eurosystem funding unless otherwise indicated. ELA funding is granted by national central banks to meet temporary liquidity difficulties at specific solvent banks, although in recent years it has been used in certain exceptional cases over a prolonged period, as in the case of the Greek banking system where it is still in use. ELA funding is included in the financing aggregate under the heading credit institutions' liabilities to the central bank in banks' balance sheets. It is important to note that this heading, shown in Chart 1 and in the memorandum item in Table 1, includes other items in addition to ELA funding (essentially, central banks' foreign currency deposits).

7 The capital key is the share of the national central banks in the capital of the ECB, calculated on the basis of the population and GDP of the EU Member States. In Table 1 it is rescaled for the euro area countries as a measure of the relative economic importance of each country.

1 TOTAL EUROSYSTEM FUNDING



2 VOLUME OF EUROSYSTEM FUNDING (b)



3 WEIGHT IN BANKING SECTOR BALANCE SHEET

Liabilities to central bank to total credit institutions' liabilities



SOURCE: ECB.

- a Data from credit institution balance sheet; includes ELA funding, among other liabilities.
 b Data on monetary policy operations from the Eurosystem disaggregated balance sheet since June 2016. Extends back, with the changes in the series liabilities to the central bank on the credit institution balance sheet.

Eurosystem funding peaked at over €1.2 trillion (more than €400 billion of which had as counterparts resident institutions in Spain), before embarking on a sustained decline facilitated by the economic policy measures adopted by the various national and European authorities and by the resultant improved access to funding markets. Key among the steps taken by the European institutions were the launch of the banking union, the granting of financial aid to Spain for recapitalisation of the banking sector and the additional steps taken by the ECB, including the declarations made by the ECB President Mario Draghi and the launch of the Outright Monetary Transactions (OMT) programme,⁸ which together helped ease the severe financial stress. By summer 2014, Eurosystem funding had declined notably to just over €500 billion (approximately €150 billion in the case of Spain).

The decrease in Eurosystem funding was interrupted when the ECB embarked on a new phase of monetary stimulus to combat the downside risks to price stability, against a

⁸ On 12 July 2012, Mr Draghi said "... the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough". Through the OMT programme, the Eurosystem could purchase government debt in the secondary public debt markets. The programme has never been activated.

	Funding for monetary policy purposes (a)				Memorandum item 1: ECB capital key rescaled	Memorandum item 2: Credit institutions' liabilities to central bank
	€ billion	% of banking assets	% of GDP	% total euro area	%	€ billion
GR (b)	11.2	6.9	11.7	1.47	2.89	20.9
IT	250.4	6.7	14.6	32.87	17.49	248.4
ES	169.7	6.2	14.6	22.27	12.56	173.2
PT	22.0	5.6	11.4	2.88	2.48	22.0
SI	1.1	2.8	2.6	0.15	1.10	1.1
AT	20.1	2.5	5.4	2.64	2.79	21.2
BE	24.3	2.4	5.6	3.19	3.52	26.2
FI	10.1	2.3	4.5	1.33	1.78	10.2
FR	114.2	1.4	5.0	14.99	20.14	156.3
SK	1.1	1.4	1.3	0.14	1.10	1.1
IE	7.5	1.4	2.5	0.98	1.65	7.6
DE	94.6	1.2	2.9	12.41	25.57	101.0
NL	28.2	1.2	3.8	3.70	5.69	28.9
CY	0.9	1.2	4.9	0.12	0.21	0.8
LT	0.3	1.1	0.7	0.04	0.59	0.3
LV	0.2	0.9	0.9	0.03	0.29	0.2
LU	5.6	0.8	10.1	0.74	0.40	5.8
EE	0.1	0.3	0.4	0.01	0.27	0.1
MT	0.1	0.2	0.7	0.01	0.09	0.1
Euro area	762	2.6	6.8			825.4

SOURCE: ECB.

a Main and long-term refinancing operations, taken from the Eurosystem disaggregated balance sheet. Reference date: 4 May.

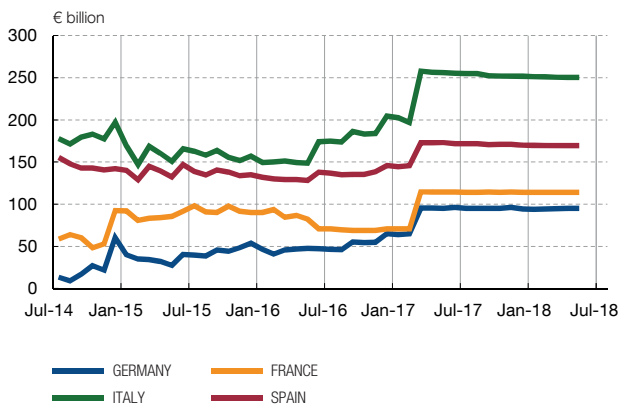
b In the case of Greece, the figures as a percentage of GDP and of total bank assets have been calculated using the data from the Memorandum item 2 column. Accordingly, they include ELA funding.

backdrop of economic weakness and sluggish bank lending. With policy rates at very low levels, the ECB added balance sheet expansion to its monetary policy instruments. Among other measures, in June 2014 it announced the TLTROs, to be held over two years. These operations were attractively priced and designed to support lending to the economy. They numbered eight in total, the first conducted in September 2014, all maturing in September 2018, and also permitting refinancing of the loans granted under the 3-year VLTROs. To reinforce the accommodative stance of the ECB's monetary policy, the TLTROs were followed by a new series of four refinancing operations (TLTRO II), between June 2016 and March 2017, with advantages consisting in lower interest rates, longer repayment periods and, again, permitting refinancing of the loans granted under the previous TLTROs. Loans under TLTRO II have a maturity of four years⁹ from their settlement date and a fixed cost of 0%, although under certain conditions where banks increase their lending to the private sector (excluding loans for house purchase) that cost may be reduced to as far as -0.4%, which is the deposit facility rate.¹⁰

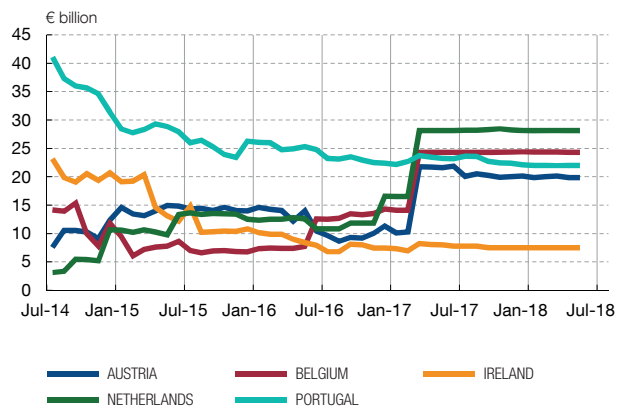
⁹ After two years, banks may make full or partial early repayment quarterly.

¹⁰ Application of a lower rate depends on the level of lending to the private sector between February 2016 and January 2018. To take advantage of the maximum interest rate reduction, the outstanding balance of a bank's loans must exceed the benchmark by at least 2.5% at 31 January 2018. Up to that limit, the interest rate level will be graduated linearly according to the percentage by which a counterparty's eligible loans exceed its benchmark.

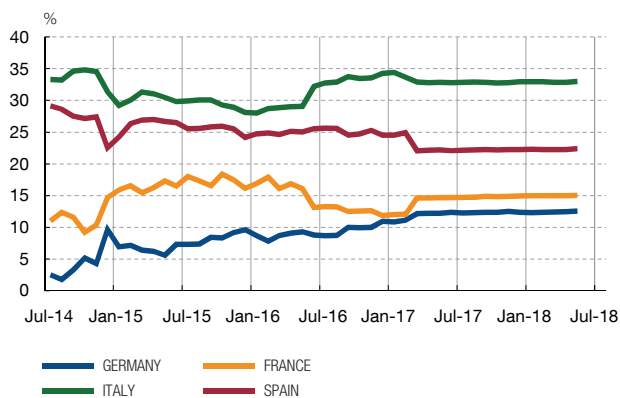
1 EUROSYSTEM FUNDING FOR MONETARY POLICY PURPOSES



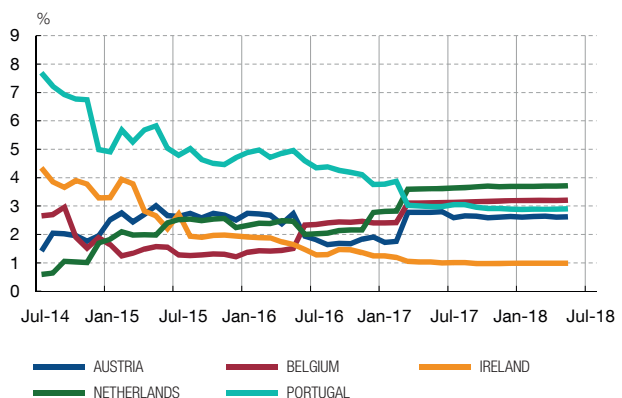
2 EUROSYSTEM FUNDING FOR MONETARY POLICY PURPOSES



3 SHARE OF TOTAL EUROSYSTEM FUNDING



4 SHARE OF TOTAL EUROSYSTEM FUNDING



SOURCE: ECB.

a Data on monetary policy operations from the Eurosystem disaggregated balance sheet since June 2016. Extends back, with the changes in the series liabilities to the central bank on the credit institution balance sheet.

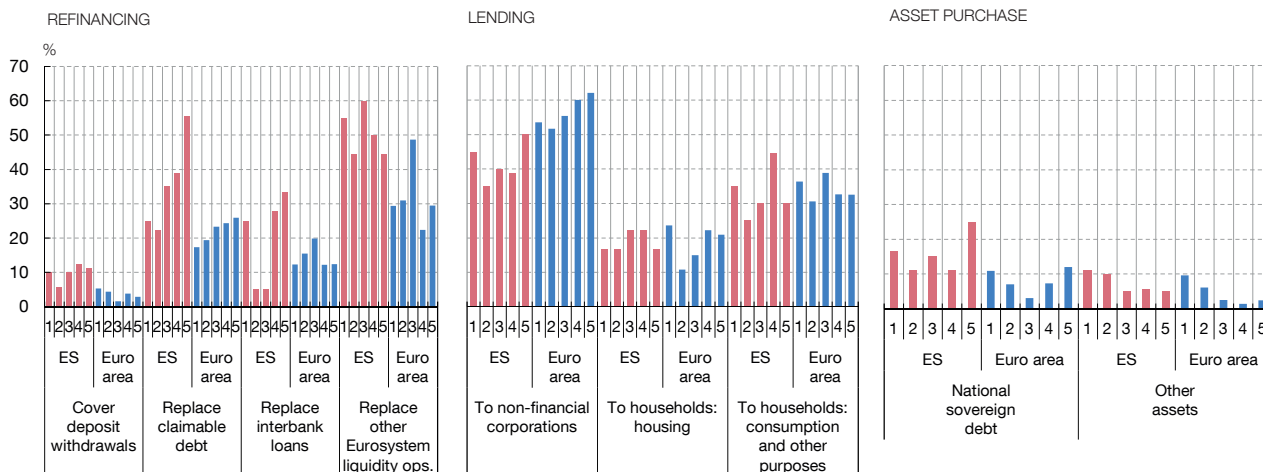
The objective of the TLTROs was to heighten the accommodative monetary policy stance, hence the attractive design that sought to attract widespread participation. These operations offered clear incentives to refinance and even increase previous Eurosystem funding,¹¹ as they assured highly favourable financing conditions for a longer period. As a result, the TLTRO II operations gave a very significant boost to Eurosystem funding, especially in the fourth and last operation in March 2017 (see Chart 2). In the first TLTRO II operation in June 2016, gross funding of €399 billion was granted, mostly used to replace funding obtained in previous TLTROs. In the second and third TLTRO II operations €45 billion and €62 billion, respectively, were granted, while in the fourth and last operation the total granted was €233 billion. These loans could be repaid before maturity, after elapse of the first two years.¹²

Since June 2014, the increase in Eurosystem funding has not been especially high in Spain, since the new facilities were used in part to replace the previous liquidity-providing

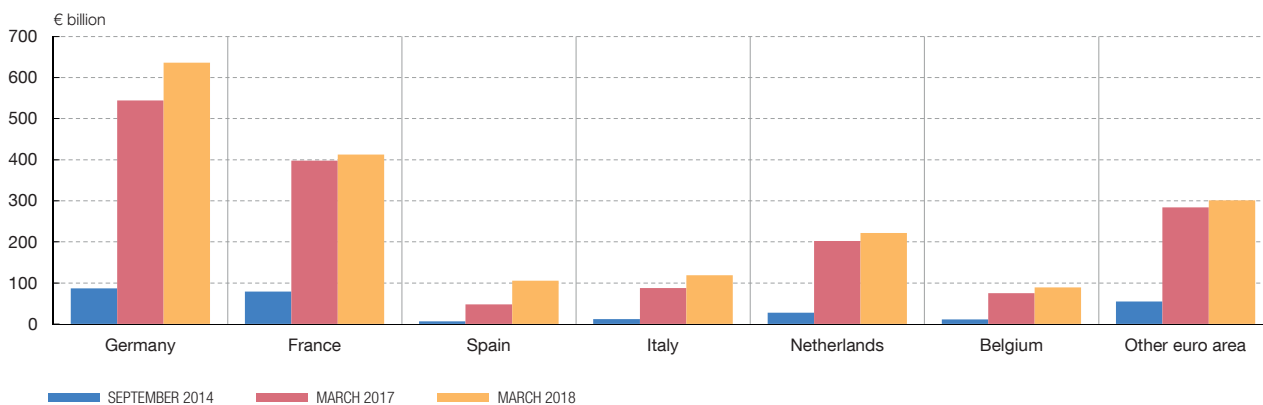
11 Participating banks would receive the full amount requested, subject to the provision of collateral (as in all other monetary policy refinancing operations) and to a maximum limit according to the total stock of eligible loans.

12 For more details, see ECB, "The targeted longer-term refinancing operations: an overview of the take-up and their impact on bank intermediation", Box 5, *Economic Bulletin*, 3/2017.

1 BANK LENDING SURVEY. USE MADE OF TLTRO FUNDS (a)



2 CENTRAL BANK RESERVES



SOURCES: ECB and Banco de España.

a Indicator = percentage of banks reporting that the funds obtained made a considerable contribution to this end × 1 + percentage of banks reporting that they made some contribution × 1/2. In each concept the results are shown for Spain and for the euro area as a whole from the five surveys conducted between July 2015 and July 2017.

operations. In this period, Spanish banks' recourse to Eurosystem funding has grown by approximately €20 billion. Thus, Spain's share of total Eurosystem funding has declined (from 30% to 22%), by contrast to the growth in the shares of Germany (from 3% to 12%), France (from 11% to 15%) and the Netherlands (from less than 1% to almost 4%). In turn, Italy's relative share of total Eurosystem funding is almost 33%, very similar to the mid-2014 level (see Charts 2.3 and 2.4).

The various waves of the Bank Lending Survey conducted between July 2015 and July 2017 indicate that, in addition to replacing other sources of funding, the funds obtained through the TLTROs were used mainly for lending to the private sector, with only a small proportion of banks reporting having used the funds to acquire other financial instruments or to cover declines in deposits (see Chart 3). Considering that replacing other sources of funding was one of the main uses of the funding obtained, the relative advantage of the TLTROs was greater in countries such as Italy and Spain where banks' borrowing costs were higher before the TLTROs were launched.

Accordingly, the continuing high weight of Eurosystem funding in Spain is a reflection of the possibility offered by the monetary policy to refinance funds obtained from previous Eurosystem operations, and of the relatively higher benefits in terms of cost. By contrast, for banks with liquidity stocks in the form of excess reserves (mainly in the core euro area countries,¹³ as shown in Chart 3.2), additional liquidity demand was less attractive. At March 2017, the central bank deposits of both the German and the French banking systems amounted to the equivalent of 17% of GDP, while in Spain and Italy they accounted for around 5% of GDP.

Developments in the composition of banking sector balance sheets

As Eurosystem funding has grown in importance, substantial changes have occurred in the size and the composition of banking sector balance sheets. Since 2012 there has been a widespread decrease in bank assets, with varying intensity from one country to another. The Spanish banking system stands out for the scale of the adjustment, against a backdrop of pronounced private sector deleveraging and restructuring and rationalisation of credit institutions (see Charts 4.1 and 4.2).

On the liabilities side, the most salient change has been the decline, both in absolute and relative terms, in funds raised in the wholesale markets (see Charts 4.3 and 4.5).¹⁴ Spanish banks stand out for their lower level of interbank funding (around 11% of the total balance sheet in 2018 Q1), compared with France (25%) and Germany and Italy (both around 15%). In general, this funding has tended to decrease in recent years (except in France) and it mainly consists of deposits of other domestic banks, including banks belonging to the same group. In the case of funds raised in the debt securities markets, included in the heading debt securities and deposits of other financial intermediaries (OFIs),¹⁵ in 2018 Q1 their weight in the Spanish banking system (44% of GDP, 20% of liabilities) was similar to that recorded in the euro area as a whole (46% of GDP, 18% of liabilities). In addition, they are the liability component that has declined the most in recent years. During the pre-crisis upturn, recourse to international wholesale markets was the main channel for raising funds and financing credit expansion in Spain, in a setting of favourable wholesale market access and low national saving. This was reflected in the Spanish economy's large financing needs, resulting in a high negative net investment position, largely channelled through the financial sector (see Chart 5). Both Spanish and European banks have countered the decline in the share of funds raised in the markets by having greater relative recourse to deposits, which make up 36% of banking sector liabilities in the euro area (see Chart 4.5), and to Eurosystem funding, which is the most important channel, among the main euro area countries, for the Spanish and Italian banking systems that were those most affected by the wholesale market tensions. In particular, positions vis-à-vis the Eurosystem amount to 6% to 7% of liabilities in the case of Spain and Italy, compared with 1% in early 2008.

On the assets side, the decline in the share of loans in the Spanish banking system stands out. This is in keeping with the sharp deleveraging of the private sector and the restructuring of credit institutions (see Charts 4.4 and 4.6). Specifically, this heading has fallen from slightly more than 60% of the balance sheet at the start of 2008 to 49% at the start of 2018, approaching the average figures for the euro area as a whole. This asset recomposition

¹³ See L. Baldo, B. Hallinger, C. Helmus, N. Herrala, D. Martins, F. Mohing, F. Petroulakis, M. Resinec, O. Vergote, B. Usciati and Y. Wang (2017), *The distribution of excess liquidity in the euro area*, ECB Occasional Paper No 200.

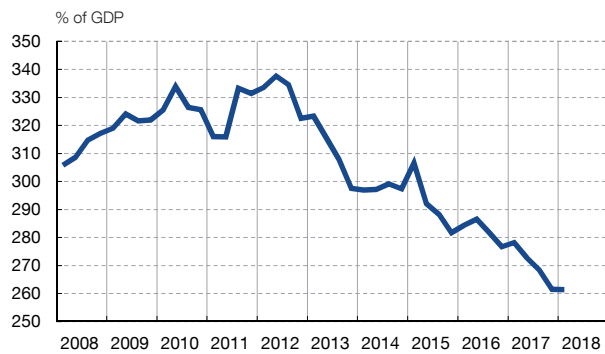
¹⁴ Recorded under the headings "Deposits, other MFIs", "Debt securities" and "Deposits, OFIs".

¹⁵ Funds obtained by banks through securitisations do not appear in banks' liabilities as securities issued but as deposits of OFIs when the loans are not removed from the balance sheet and the operation entails funds being raised, in other words, when they are not retained securitisations.

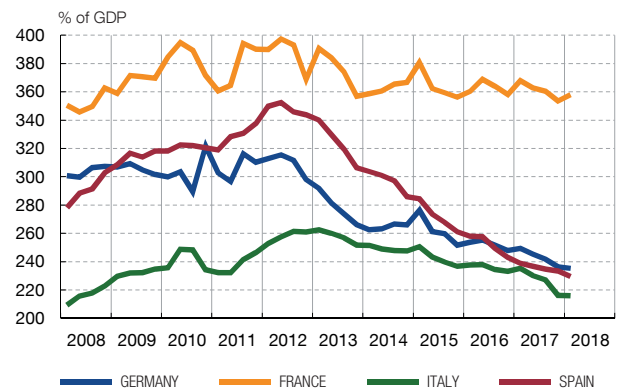
CREDIT INSTITUTION BALANCE SHEET (a)

CHART 4

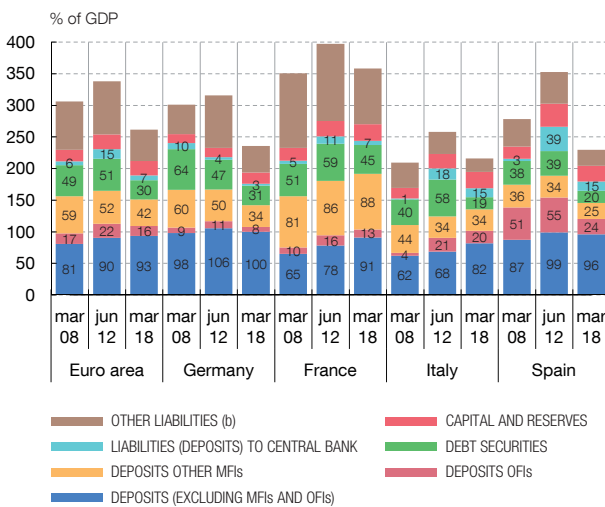
1 AGGREGATED CREDIT INSTITUTION BALANCE SHEET
Euro area



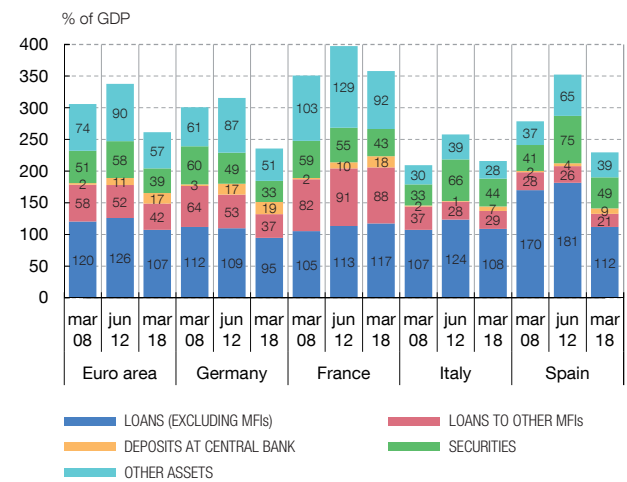
2 AGGREGATED CREDIT INSTITUTION BALANCE SHEET
Countries



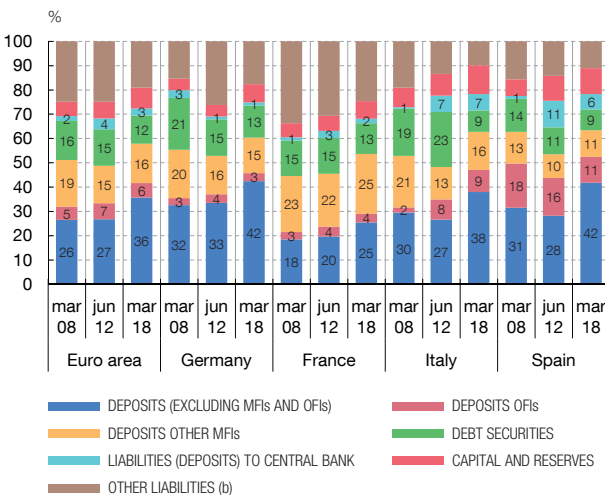
3 CREDIT INSTITUTION LIABILITIES



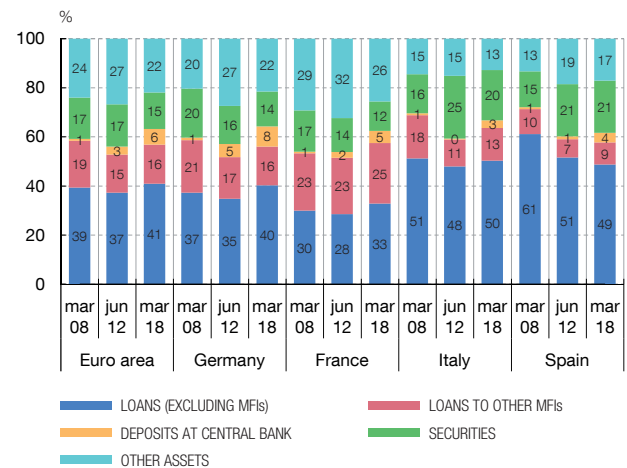
4 CREDIT INSTITUTION ASSETS (c)



5 COMPOSITION OF CREDIT INSTITUTION LIABILITIES



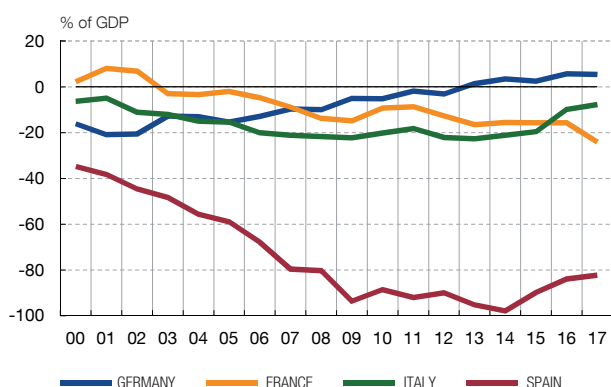
6 COMPOSITION OF CREDIT INSTITUTION ASSETS (c)



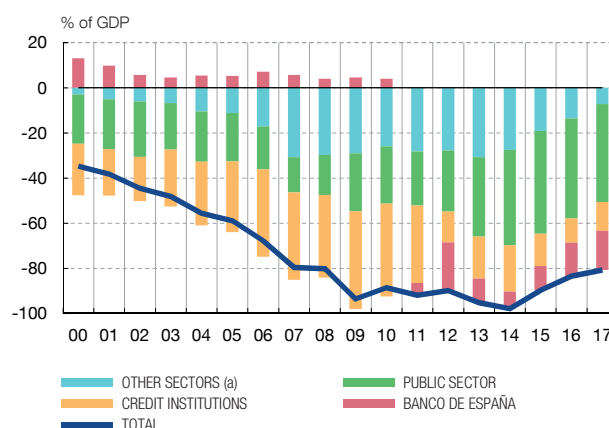
SOURCE: ECB (Aggregated BSI statistics).

- a MFI sector aggregated balance sheet data, excluding the central bank and money market funds. Individual balance sheets are not consolidated; accordingly, they exclude non-euro area subsidiaries.
- b "Other liabilities" includes liabilities vis-à-vis the rest of the world, which for the euro area account for around 40% of this component.
- c "Loans" are to euro area residents and exclude loans to other MFIs. "Securities" include debt instruments, shares and other equity, issued by euro area residents. "Other assets" includes external (non-euro area) assets, which in the euro area amount to around 50% of this component.

1 NET INTERNATIONAL INVESTMENT POSITION
International comparison



2 SPAIN'S NET INTERNATIONAL INVESTMENT POSITION
Breakdown by institutional sector



SOURCES: ECB and Banco de España.

a Essentially includes non-financial corporations and non-monetary financial corporations.

has been to the benefit of securities holdings, which have increased by 6 pp in the period up to 21% of the balance sheet, above the average for the euro area banking systems. In the euro area as a whole the most salient change has been the increase in the share of deposits vis-à-vis the Eurosystem, up from 1% to 4% of assets between 2008 and 2018, which is consistent with the liquidity generated by the Eurosystem’s balance sheet expansion policy. This increase was observed across the board, although with varying intensity from one country to another; it was more moderate, among the main euro area countries, in the Spanish and Italian banking systems, and more marked in the German and French ones.¹⁶

Conclusions

Recourse to Eurosystem funding by Spanish banks is relatively high, in terms of GDP and its weight in the banking sector balance sheet, although the factors behind the developments in this source of funding have changed substantially in recent years. In 2014 the decline in the Spanish banking system’s recourse to Eurosystem funding was interrupted, coinciding with the start of a new monetary stimulus phase based on Eurosystem balance sheet expansion. Currently, almost all liabilities to the Eurosystem stem from the TLTRO II operations conducted in 2016 and 2017, to mature in June, September and December 2020 or in March 2021, depending on the tender to which they pertain. Under the TLTRO II, previous Eurosystem funding may be refinanced and even increased, on highly favourable conditions (low interest rates and long repayment periods). The TLTROs were mainly used to replace other sources of funding, and were thus more advantageous to countries such as Spain where at the time banks’ borrowing costs were still relatively higher. By contrast, for banks with liquidity stocks in the form of excess reserves, the TLTROs were less attractive.

That said, the increase in recourse to Eurosystem funding by the Spanish banking system since mid-2014 is not especially high in comparison with that of other countries and, in consequence, since that date its share of total Eurosystem funding has declined.

16 For more details on the factors affecting the distribution of excess reserves by country see, for example, J. Martínez Pagés (2016), “The Eurosystem’s quantitative easing measures and the financial account”, *Economic Bulletin*, April, Banco de España.

Since June 2018, and with a quarterly frequency, banks may make early repayment, in full or in part, of the amounts borrowed under TLTRO II, provided that at least two years have elapsed from the settlement date. Specifically, on 27 June, 41 euro area counterparties made early repayment of loans amounting to approximately €11 billion. The long maturities and the favourable conditions in the financial markets in the more recent period have afforded banks more scope to refinance or repay these debts in an orderly manner.

Data cut-off date: 29.6.2018.

Publication date: 5.7.2018.