ECB’s very attractive TLTRO II loans

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A new TLTRO II aimed at boosting private sector lending

- The ECB’s new TLTRO II provides very cheap bank funding with a long maturity and no mandatory early repayments.

- The TLTRO II has a fixed size and maturity, while the price of loans varies with eligible net lending.
  - **Size (fixed):** A total amount of up to 30% of eligible loans (loans to non-financial corporations and households excluding loans for house purchases) as at January 2016.
  - **Maturity (fixed):** Four years from settlement date with no mandatory early repayments.
  - **Price (variable):** Fixed at the MRO rate prevailing at the time of allotment but by exceeding the lending benchmark the rate can be as low as the deposit rate at the time of allotment.

- The lending benchmark should not be difficult to beat, thus the demand for TLTRO II loans should be high. For most core countries, the benchmark is set at zero, while a large majority of the periphery countries can continue with declining lending and still get an interest rate on the TLTRO II loans as low as the deposit rate (see more on page 3).

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**Details about the ECB’s TLTRO II**

<table>
<thead>
<tr>
<th>Total eligible amount</th>
<th>30% of loans to non-financial corporations and households excluding loans for house purchases as at 31 January 2016 less any outstanding amount under the first TLTRO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maturity</td>
<td>Four years from settlement date, with the possibility of repayment after two years at a quarterly frequency</td>
</tr>
<tr>
<td>Repayments</td>
<td>No mandatory early repayments, but possible after two years from the settlement of each operation at a quarterly frequency</td>
</tr>
<tr>
<td>Interest rate</td>
<td>Fixed at the MRO rate prevailing at the time of allotment, but by exceeding the lending benchmark the rate can be as low as the deposit rate at the time of allotment</td>
</tr>
<tr>
<td>Conditions for receiving a rate reduction</td>
<td>Banks exceeding their benchmark stock of eligible loans by 2.5% in total as at Jan-18 will receive the max rate reduction equal to the difference between the MRO rate and the deposit rate at time of take-up. Up to this size the decrease in the interest rate will be graduated linearly depending on the percentage by which a bank exceeds its benchmark stock of eligible loans.</td>
</tr>
<tr>
<td>Benchmark (positive eligible net lending)</td>
<td>Banks which had positive eligible net lending in the 12m period to January 2016 will have net lending benchmark set at zero</td>
</tr>
<tr>
<td>Benchmark (negative eligible net lending)</td>
<td>Banks which had negative eligible net lending in the 12m period to January 2016 will have net lending benchmark set equal to the eligible net lending in that period</td>
</tr>
<tr>
<td>Auctions</td>
<td>Four operations conducted from June 2016 to March 2017 at a quarterly frequency</td>
</tr>
</tbody>
</table>

Source: ECB, Danske Bank Markets
The interest rate on TLTRO II loans depend on bank lending

The interest rate on TLTRO II loans depends on banks’ eligible net lending relative to their benchmark – for the euro area aggregate, the benchmark is set at zero.

 Eligible net lending above 2.5% of benchmark loan stock
 =>
 TLTRO II interest rate = deposit rate (-40bp)

 Eligible lending above benchmark, but below 2.5% of loan stock
 =>
 TLTRO II interest rate between MRO and deposit rate

 Eligible lending below benchmark
 =>
 TLTRO II interest rate = MRO rate (0bp)

Most core countries have a lending benchmark set at zero, while the periphery countries can continue with declining lending and still get an interest rate below zero.

A positive figure in the chart implies the banks in the country have on aggregate a benchmark set at zero.

A negative figure in the chart implies the banks in the country have on aggregate a negative benchmark equal to eligible net lending.

Source: ECB, Danske Bank Markets

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The lending benchmarks should not be difficult to beat

On aggregate, banks in the core countries need to beat a benchmark set at zero to get a negative interest rate on the TLTRO II loans

Banks in the periphery countries can on aggregate continue with declining lending equal to eligible net lending in the 12M period to Jan-16 and get a negative interest rate

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Banks are able to borrow a large, fixed amount on the TLTRO II

Euro area banks will be able to borrow a total amount of EUR1.693bn on the new TLTRO II loans and due to the attractive conditions we expect relatively high demand.

Banks have on aggregate taken EUR418bn on the ECB’s TLTRO I but TLTRO II is cheaper and the maturity is longer, which should result in higher demand from banks.

### MFI eligible loan stock* (Jan-16) | TLTRO II allowance (30% of eligible loan stock)

<table>
<thead>
<tr>
<th>Country</th>
<th>EUR bn</th>
<th>EUR bn</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Euro Area</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>1.356</td>
<td>407</td>
</tr>
<tr>
<td>France</td>
<td>1.166</td>
<td>350</td>
</tr>
<tr>
<td>Netherlands</td>
<td>435</td>
<td>130</td>
</tr>
<tr>
<td>Belgium</td>
<td>138</td>
<td>41</td>
</tr>
<tr>
<td>Austria</td>
<td>214</td>
<td>64</td>
</tr>
<tr>
<td>Finland</td>
<td>105</td>
<td>32</td>
</tr>
<tr>
<td><strong>Core countries</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Italy</td>
<td>1.057</td>
<td>317</td>
</tr>
<tr>
<td>Spain</td>
<td>692</td>
<td>207</td>
</tr>
<tr>
<td>Greece</td>
<td>131</td>
<td>39</td>
</tr>
<tr>
<td>Portugal</td>
<td>104</td>
<td>31</td>
</tr>
<tr>
<td>Ireland</td>
<td>71,056</td>
<td>21</td>
</tr>
<tr>
<td><strong>Periphery countries</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>2.054</td>
<td>616</td>
</tr>
<tr>
<td><strong>Other EA countries</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>176</td>
<td>53</td>
</tr>
</tbody>
</table>

*Private sector loans excl. lending for house purchase

Source: ECB, Danske Bank Markets
Demand for loans from the private sector is needed

In the latest bank lending survey, which was released in January 2016, banks reported a high increase in demand for loans from SMEs, large enterprises and consumers.

Demand for loans and credits from enterprises is increasingly due mainly to financing needs for fixed investments as well as for inventories and working capital.

The TLTRO II loans will only result in higher bank lending, if there is demand for loans from the private sector.

Source: ECB, Danske Bank Markets

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Low cost of borrowing continues to support demand for loans

The ECB’s low policy rates have resulted in a considerable decline in the cost of borrowing to the private sector, which should continue to support demand for loans.

Banks continue to report easing price terms and conditions on loans to enterprises, so the cost of borrowing is not about to increase.

Source: ECB, Danske Bank Markets

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The TLTRO II should support bank lending longer term

- TLTRO II should clearly support the supply side of a further ease in the loan conditions to the private sector.

- From the demand side, we expect enterprises and consumers to continue to increase their demand for loans and credits, which will support the effectiveness of the TLTRO II loans. However, in the near term we expect modest growth in investments due to a cautious approach from businesses. This should follow as Brexit risks, weakness in global manufacturing and a stronger effective euro are headwinds to business sentiment.

- Another constraint to improved lending conditions is bank regulation. However, as the chart to the right shows, bank lending has picked up since the ECB finalised its Asset Quality Review (AQR) of banks’ balances at end-2014.

- Over a longer term perspective, we expect bank lending to continue to grow, as we look for stronger economic growth in 2017 and the continued very low costs of borrowing support demand for loans for new investments.

Bank lending to the private sector improved in 2014-15 but lost some momentum at the end of 2015 – TLTRO II loans aim to maintain the progress in lending.

Source: ECB, Danske Bank Markets

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