EUROPEAN CENTRAL BANK

EUROSYSTEM

COURTESY TRANSLATION

Mario DRAGHI
President

Mr Marco Valli
Mr Marco Zanni
Member of the European Parliament
European Parliament
60, rue Wiertz
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Frankfurt, 6 January 2015

L/MD/15/3

Re: Your letter (QZ-42)

Honourable Members of the European Parliament, dear Mr Valli, dear Mr Zanni,

Thank you for your letter, which was passed on to me by Mr Roberto Gualtieri, Chairman of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 6 November 2014.

The Governing Council of the European Central Bank (ECB) has introduced the targeted longer-term refinancing operations (TLTROs) to restore impairments in the monetary policy transmission mechanism by supporting bank lending to the real economy, and to reinforce the ECB's accommodative monetary policy stance. In line with this objective, borrowing in the six TLTROs to be conducted in 2015 and 2016 will be fully conditional on banks having exceeded their institution-specific benchmarks for lending to non-financial corporations and households (excluding loans to households for house purchases).

In the first two operations conducted in September and December of 2014, banks borrowed against their initial borrowing allowance. The targeted character of these first two TLTROs was ensured by the fact that banks must repay their borrowings two years ahead of the original maturity date of the operations should their lending to the real economy fall short of their individual benchmarks. This will importantly shape banks' incentives to lend. Indeed, banks that do not step up lending to ensure that their benchmarks are met will need to limit the duration of assets that they fund with the TLTROs so that they can repay the borrowed funds in September 2016. Given the low yields on low-risk financial assets with an investment horizon of less than two years, there is little incentive to pursue a strategy of borrowing from the TLTROs for two years in order to invest in such securities.

In addition, beyond the direct incentives for banks to increase lending, the design of the TLTROs is also intended to support other monetary policy transmission channels. In particular, banks are expected to partly use the funds borrowed as a substitute for more costly alternative sources of funding or to acquire new assets. This should trigger a chain of portfolio reallocations across a broad range of investors and asset classes that should ultimately result in an overall compression of yields, and therefore in an easing of financing conditions in the economy. This aspect of the TLTROs relies on channels very similar to those activated by other non-standard monetary policy measures that the ECB's Governing Council has introduced recently, in particular the asset-backed securities purchase programme (ABSPP) and the third covered bond purchase programme (CBPP3).

Yours sincerely,

[signed]

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