Analysis

# Record amount of credit granted to Finnish banks

Monetary policy | 11 September 2020 | Kristian Tötterman

AUTHOR



Kristian Tötterman
Market Analyst

Since its inception the Eurosystem has implemented its monetary policy through credit operations conducted as tenders. In these operations, the Eurosystem grants credit against collateral to euro area banks in order to pursue its monetary policy objectives. Finnish banks and banks with branches in Finland can apply for funding from the Bank of Finland, where the tenders are carried out in practice. During the coronavirus crisis, credit operations have helped to facilitate bank lending to the private sector despite the crisis. In fact, Finnish banks' take-up of funding from these operations has been record-high.



## Credit operations are an important part of the ECB's response to the coronavirus crisis

Current credit operations by the Eurosystem can be divided into regular and non-standard operations. Credit operations here refer to the Eurosystem's liquidity-providing market operations[1]. Regular operations consist of one-week main refinancing operations (MROs) and three-month longer-term refinancing operations (LTROs), under which euro area banks may apply for money at the interest rate of the main refinancing operations.

Other operations are referred to as non-standard operations. Non-standard operations conducted in 2020 include the third series of targeted longer-term refinancing operations (TLTRO III), bridge LTROs, longer-term pandemic refinancing operations (PELTROs) and one-week and 12-week US dollar liquidity-providing operations.

In March, the coronavirus pandemic led to a historically rapid deterioration of financing conditions, to which the Governing Council of the ECB responded by further easing monetary policy and securing euro area banks' access to euro and dollar financing. The ECB's decisions were reflected in credit operations both as eased and more flexible terms for existing operations and as entirely new operations.

Out of the euro-denominated operations, the conditions of TLTRO III operations launched in 2019 were set at their most favourable level ever, in order to provide banks with the best possible conditions to support private sector lending despite the crisis. The quarterly TLTRO III operations have a maturity of three years with an interest rate that can be as low as −1% over the period 24 June 2020 – 23 June 2021 and an average ECB deposit facility rate (currently −0.5%) outside this period. In order to achieve the most favourable interest rate, banks must not reduce the aggregate amount of their private sector lending (excluding mortgages) between 1 March 2020 and 31 March 2021.

In addition to easing the conditions of TLTRO III, the Governing Council also decided to launch bridge longer-term refinancing operations and pandemic-related longer-term refinancing operations (PELTROs), which are entirely new euro-denominated operations. The bridge LTROs provided banks an opportunity to apply for loans on a weekly basis between 16 March 2020 and 8 June 2020 at an average ECB deposit facility interest rate of −0.5%. All bridge LTROs matured on 24 June 2020, which was also the settlement day of the fourth operation of TLTRO III. In practice, the bridge operations ensured the availability of very affordable central bank euro financing in the midst of the crisis, up to the fourth TLTRO III operation.

The PELTROs were first launched in May, and under them banks can apply for loans on a monthly

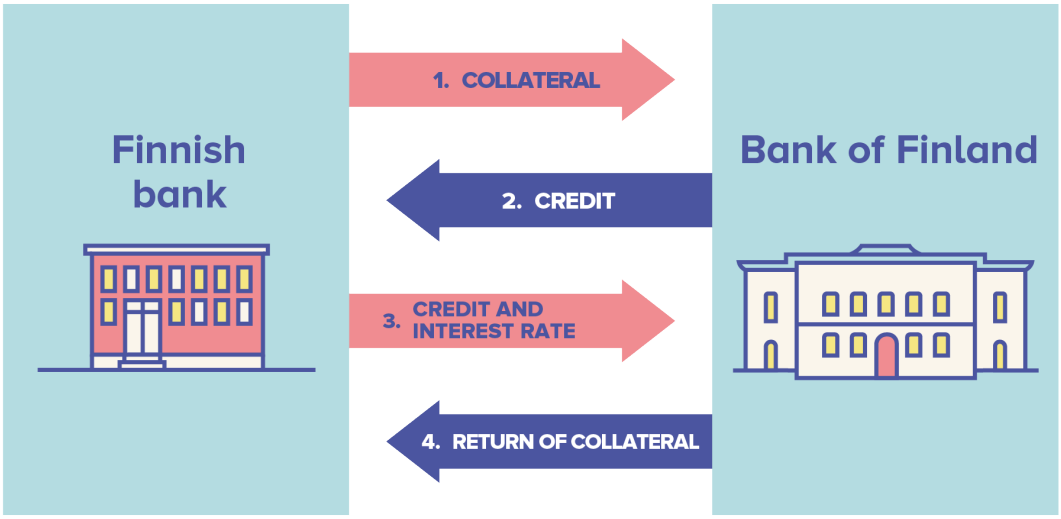
basis until December, which mature from July to September 2021. The PELTROs are conducted at an interest rate of 25 basis points below the average rate applied on the Eurosystem's main refinancing operations over the life of the respective PELTRO. The PELTROs give banks access to affordable financing without conditions similar to TLTRO III loans.

In addition to euro-denominated loans, the Eurosystem also offers euro area banks dollar-denominated loans. The Eurosystem acquires dollars for these operations from the Federal Reserve System of the United States (Fed) through a foreign exchange swap arrangement. The coronavirus crisis curbed access to dollar financing globally as market participants hoarded USD liquidity and did not lend it further. The availability of dollar financing was supported by lowering the price of the Eurosystem's dollar operations, by increasing the frequency of these operations and by also offering 12-week operations in addition to the one-week operations.

Chart 1 illustrates the change in Eurosystem credit operations brought about by the turmoil in the financial markets caused by the coronavirus pandemic. During the first half of 2020, the Eurosystem offered up to 139 credit operations to banks, compared with 58 operations during the same period in 2019. The single biggest cause for the increase was the dollar operations that were conducted on a daily basis between 23 March and 30 June. In addition, the operations were diversified, mainly as a result of the entirely new operations planned for the coronavirus crisis, i.e. the bridge longer-term refinancing operations and PELTROs.

Chart 1.

**Granting credit to banks**




Source: Bank of Finland.

The coronavirus crisis was also clearly reflected as higher loan volumes in credit operations (Table

1). In the first half of this year, euro area banks borrowed a total of EUR 1,854 billion in euro loans and a total of USD 265 billion in US dollar-denominated loans. In the first half of 2019, the corresponding figures were EUR 162 billion and USD 3 billion. The majority of withdrawn and still open euro loans are TLTRO III loans due to their historically favourable borrowing conditions. The banks clearly sought financing from the Eurosystem's refinancing operations more strongly than before. However, the growing demand reflects not only the deterioration of the financial conditions due to the coronavirus pandemic, but also the more diverse and favourable credit operations.

Loans to Eurosystem banks under credit operations, EUR and USD billion

| | 2020H1 | 2019H1 |
|---|---|---|
| Main refinancing operations (MROs) | 21 | 156 |
| Longer-term refinancing operations (LTROs) | 5 | 7 |
| Bridge LTROs | 389 | – |
| Pandemic emergency longer-term refinancing operations (PELTROs) | 16 | – |
| Targeted longer-term refinancing operations (TLTRO III) | 1,423 | – |
| **Total loans in EUR** | **1,854** | **162** |
| | | |

| Loans to Eurosystem banks under credit operations, EUR and USD billion | | |
|---|---|---|
| US dollar-denominated credit operations, 7 days | 115 | 3 |
| US dollar-denominated credit operations, 12 weeks | 150 | – |
| **Total loans in USD** | **265** | **3** |
| Source: European Central Bank. | | |

This spring, Finnish banks and banks operating in Finland also participated clearly more than usual in credit operations by the Bank of Finland. In fact, market participants from Finland participated in all different types of euro and US dollar operations conducted in 2020. During the first half of the year, more than ten Finnish counterparties applied for euro funding totalling over EUR 18 billion and for dollar funding for a total of USD 4 billion. Just as in the euro area, most of the loans granted by the Bank of Finland were TLTRO III loans. In June, Finnish market participants borrowed close to a total of EUR 17 billion under these operations. At the end of July, Finnish banks' central bank funding amounted to a total of just over EUR 20 billion.

## The Bank of Finland grants credit to Finnish banks

Eligible counterparties to the Eurosystem's monetary policy operations are euro area credit institutions (banks) and euro area branches of non-euro area credit institutions. Counterparties to the monetary policy of the Bank of Finland, on the other hand, consist of Finnish banks and branches of Nordic banks operating in Finland. The Bank of Finland currently has 16 monetary policy counterparties, while there are approximately 2,000 counterparty banks throughout the Eurosystem.

To act as a counterparty to Eurosystem credit operations, a bank must be financially sound and be subject to minimum reserve requirements[2] (i.e. hold a minimum reserve with the central bank) and to the harmonised financial supervision within the EU. By requiring that counterparties be

financially sound, the Eurosystem is protected against the counterparty risk to the bank, i.e. the risk that the bank would go bankrupt and would not be able to repay its loans. The financial soundness of a given counterparty is assessed against a set of indicators common to the Eurosystem and the fulfilment of the criteria is monitored on an ongoing basis.

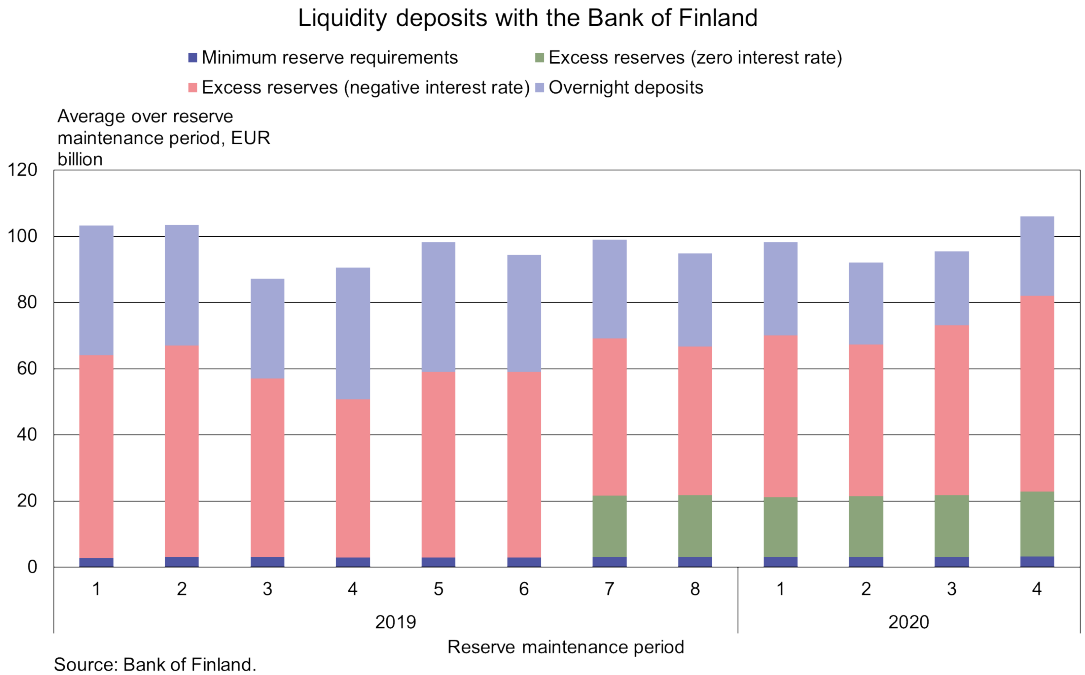
At the Bank of Finland, counterparty banks are closely monitored in their roles as monetary policy counterparties as well as securities issuers. Any changes in the ownership structure will also have an impact on the counterparty perspective.

In order to participate in credit operations, a bank needs to be approved in advance as a monetary policy counterparty to the Bank of Finland. The bank must have an account with the Bank of Finland for applying for credit, have access to the tender system of the Bank of Finland, and have arrangements for providing collateral to the Bank of Finland.

Credit application takes place by participating in the tender operations via the Bank of Finland's tender system. The auction begins with a tender announcement from the ECB, which the Bank of Finland forwards to Finnish banks. Following the tender announcement banks may submit bids to the auction. The Bank of Finland supervises the submission of bids and may assists banks in the submission process. After the closing time for the submission of bids, the Bank of Finland will close the auction and forward the bids submitted by the banks to the ECB. Thereafter, the ECB calculates the allotment[3] of the auction and submits it to the Bank of Finland. Finally, the ECB publishes the public information of the allotment decision.

After the tender procedure, the Bank of Finland grants monetary policy credit to the counterparty bank against collateral. The bank will repay the capital with interest when the loan matures. After that, the Bank of Finland will release the collateral back to the credit institution.

Chart 2.




Source: Bank of Finland.
bofbulletin.fi
25 Aug 2020

In addition to running the tender procedure and granting credit, the Bank of Finland also advises Finnish banks on issues related to credit operations and informs banks about new credit operations and changes in old credit operations.

The Bank of Finland's experts participate in policy preparation related to credit operations in working groups and committees within the Eurosystem, where the conditions of the operations are planned. Other parties in the Bank of Finland also participate in the policy preparation of the credit operations, which are ultimately decided by the Governing Council of the ECB. The Bank of Finland thus influences the planning of credit operations in many stages and ultimately implements them in Finland.

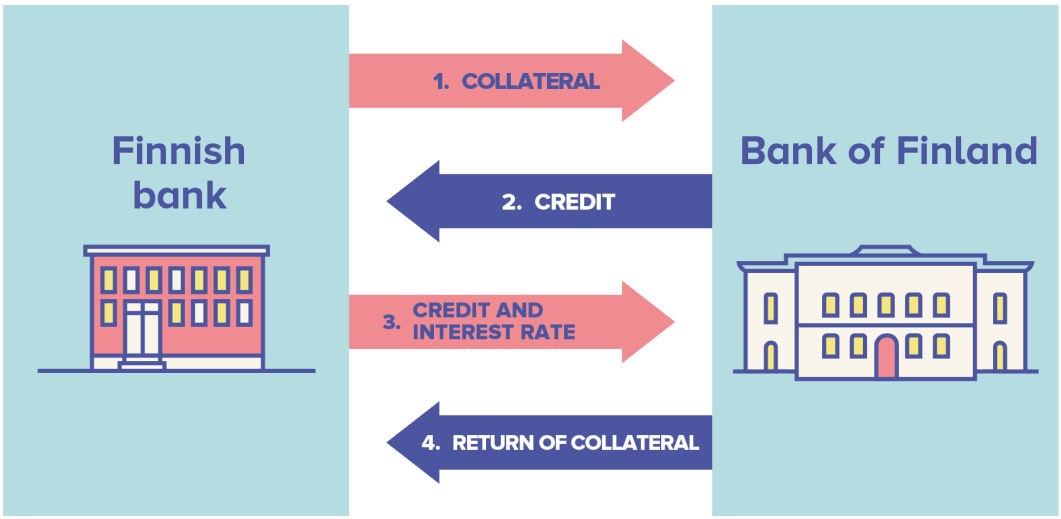
## Finnish banks hold a central bank account with the Bank of Finland

The central bank deposits of Finnish banks in the Bank of Finland remained very stable and averaged around EUR 95.3 billion over the first three maintenance periods of 2020 (Chart 3). However, in the fourth maintenance period, deposits increased to around EUR 106.1 billion, mainly as a result of the credit operations increased by the TLTRO III loans. Finnish market participants have made almost full use of the possibility offered by the two-tier system for

deposits free from negative interest rates[4]. The system was introduced in the seventh maintenance period of 2019.

Chart 3.

**Granting credit to banks**




Source: Bank of Finland.

The Bank of Finland is also responsible for tasks related the Eurosystem's liquidity management, such as reporting to the ECB on the use of central bank deposits and standing facilities by clients of the Bank of Finland. Liquidity management also includes monitoring the balance sheet of the Bank of Finland and forecasting the development of the so-called autonomous factors for the ECB. The autonomous factor forecast aims to anticipate changes in items in the central bank's balance sheet that are beyond the central bank's control, but which influence the amount of central bank money in the banking system. Such items include the demand for banknotes and central government deposits with the central bank. The aim is to anticipate changes as they may affect short-term market rates. However, the increase in central bank money has reduced the importance of the forecast over the past few years.

Central bank money arising from Eurosystem securities purchases and credit operations with commercial banks is always deposited back with the central bank. When, for example, the Bank of Finland purchases a security from a commercial bank as part of a monetary policy purchase programme, it creates new central bank money to purchase the security. The central bank money in question will end up as the commercial bank's deposit with one of the Eurosystem's central banks. When a client of the commercial bank in question then transfers funds or makes payments to another commercial bank, the central bank money is transferred to the account of the receiving commercial bank with one of the Eurosystem's central banks. In a credit operation, the central

bank transfers the credit to the applying commercial bank's central bank account. The central bank money created by the Eurosystem thus circulates in a closed system between the central bank accounts of different commercial banks. Central bank money is removed from this closed system when the security matures or the credit operation is repaid.

## Notes

1. In addition to the credit operations, the ECB's market operations toolkit includes, for example, liquidity-absorbing operations and securities purchases. For the moment, there are no open liquidity-absorbing operations. The last one was conducted in summer 2014. Securities purchases, or purchase programmes, are described in the second feature article of the Bank of Finland Bulletin. ↑
2. All banks located in the euro area are subject to the minimum reserve requirements. In order to fulfil this requirement, they must deposit a certain amount of their assets with the national central bank of the country in which they are located. A bank's minimum reserve requirement is set for six-week periods called maintenance periods. The level of reserves is calculated on the basis of the bank's balance sheet before the start of the maintenance period. ↑
3. Since the financial crisis, the Eurosystem has applied a fixed-rate full allotment policy on all monetary policy tender operations, where the bids submitted by banks are fully accepted at a pre-determined interest rate. Thus, the practice no longer resembles an auction in the traditional sense, as banks do not compete against each other for central bank credit like they did before the financial crisis. ↑
4. Read more about the two-tier system in Kristian Tötterman's article: The Eurosystem's two-tier system for remunerating excess liquidity holdings https://www.bofbulletin.fi/en/2019/4/the-eurosystem-s-two-tier-system-for-remunerating-excess-liquidity-holdings/ ↑

## Keywords

COVID-19, financial markets, monetary policy