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Series: Governments submit to "Too Big to Fail" banks
(part 6)

The big private banks run on LTRO

- Features -

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From 2012, the banks were overflowing with cash and made massive purchases of the bonds issued by their own countries. Sovereign debt securities do not require equity, as they are considered to be non-risk.

In Spain, for example, Spanish banks borrowed as much as €300 billion for three years at a rate of 1% from the ECB within the LTRO framework. [2] Part of this sum has enabled them to increase their purchases of debt securities issued by the Spanish treasury. The evolution is quite striking. Towards the end of 2006, the Spanish banks only held €16 billion of public securities from their own country. By 2010, they had increased their purchases of Spanish public securities to a level of €63 billion. In 2011 they again increased their purchases, and their holdings in Spanish securities amounted to €94 billion. But thanks to the LTRO, their acquisitions literally exploded – the volume of their holdings doubled in a few months to reach €184.5 billion in July 2012. [3] Clearly the operation was very profitable for them. Whereas they were borrowing at 1%, they could buy 10-year Spanish securities with an interest-rate that varied between 5.5 and 7.6% in the second semester of 2012. In early 2014 Spanish banks could still borrow at 0.25% and then lend to the Spanish State at around 4%. In June 2014, they borrowed at 0.15% and lent at around 3%. In November 2014, they borrowed at 0.05% from the ECB and lent at around 2.1% to Spain. [4]

In Italy between late December 2011 and March 2012, the Italian banks borrowed €255 billion from the ECB within the LTRO framework. [5] Whereas in late 2010 the Italian banks held €208.3 billion in bonds from their country, that amount increased to €224.1 billion in late 2011, a few days after the start of the LTRO. Then, they used the credits they received from the ECB for massive acquisitions of Italian securities. In September 2012 the total value of the securities they held amounted to €341.4 billion. [6] As in the case of Spain, it was a very profitable operation – they borrowed at 1% and by purchasing 10-year Italian securities, they obtained an interest-rate that varied from 5% to 6.6% in the second semester of 2012. In March 2014, Italian banks could still borrow from the ECB at 0.25% and then lend to the Italian State at about 3.4%. As from June 2014 these borrowing and lending rates became respectively 0.15% and 3%. In November of the same year these same rates lowered to 0.05% when borrowing from the ECB and to 2.3% when lending to the Italian State. [7]

The same phenomenon was repeated in most Eurozone countries. A part of the assets of the European banks were relocated to their countries of origin. Concretely, what happened is that the share of public debt of a given country held by the financial institutions in that same country increased very perceptibly during 2012 - 2014. That development reassured the governments of the Eurozone, in particular those of Spain and Italy, since they found that they had less difficulty in selling their bond issues. The ECB seemed to have found the solution. Lending massively to the private banks saved them from a critical situation and spared certain governments the pain of launching massive new bank bail-out plans. [8] The money lent to the banks was used in part to purchase public debt securities from Eurozone States. This stopped the increase in interest-rates in the most fragile countries and even resulted in lower rates for others.

It is easy to see that, from the point of view of the interests of the populations of the countries concerned, a very different approach should have been adopted – the ECB should have lent directly to the governments at less than 1%, or even without interest. The banks should also have been socialized under popular control.

Instead, the ECB put the private banks on life support by extending an unlimited line of credit at a very low interest-rate (between 0.75 and 1%). The banks used this windfall of public financing in different ways. As we just saw, on the one hand, they purchased sovereign-debt securities from countries like Spain and Italy who, under pressure from the banks, granted them high rates of remuneration (between 5% and 7.6% at 10 years, between 3.4% and 4% in the first quarter of 2014, between 2.1% and 2.3% in November 2014).

On the other hand, they deposited a part of the credit that had been extended to them by the ECB... in the ECB! From €300 to 400 billion were deposited by the banks with the ECB as call money at an interest-rate of 0.25% in early 2012, and 0% since July 2012. In February 2014 more than €50 billion was deposited as call money at the ECB at 0%. In June 2014 the ECB imposed, on the banks, a fee of 0.10% (later increased to 0.20% [9] in September 2014). Officially this was to put the pressure on the banks to lend the money to consumers and businesses rather than pay for its storage. This did not work, these kinds of loans stagnated, and in some countries even decreased.

Why did the banks do this? Because they needed to show other bankers and private suppliers of credit (Money Market Funds, pension funds, insurance companies) that they have ready cash to face the potential explosion of the time-bombs that are on their books. Without this, potential lenders would shun them, or else demand very high interest-rates, their stockholders would run and their stock market quotations would crumble.

With the same objective of reassuring private lenders, they also purchased sovereign bonds from governments that are free of short or medium term risk—Germany, Holland, France and so on. The demand was such that the two-year bonds of the governments in question sold at a rate of 0% or even with a slightly negative yield (not counting inflation). The rates paid by Germany and the other countries that are considered financially sound dropped significantly thanks to the ECB's policy and the increasing seriousness of the crisis affecting the periphery countries.. German ten year bonds were paying 1.6% at the beginning of 2014, 1.4% in July, 1.2% in August and were as low as 0.8% in November 2014. This resulted in a flight of capital from the European periphery towards the center. German securities are so safe that if cash is needed, they may be negotiated overnight without loss. Banks acquire them not for the purpose of earning money, but to have deposits or highly liquid securities in the ECB that are immediately available, so as to create the (often false) impression of solvency and thus appear to be able to deal with unforeseen events. They make profits by lending to Spain and Italy, which averages out losses they might take on the German securities. However, borrowing at 0.05% and lending at 0.8% makes for comfortable profits.

Eric Dor, Associate professor at the IÉSEG School of Management, has demonstrated, using EBA (European Banking Authority, which regulates banking activities) statistics, that the European banks are so attached to European public bonds that the amounts they hold represent several times their hard capital and the degree to which the banks are exposed to these bonds. The ratio compares the volume of the bonds held by the Banks of a given country to their real capital. [10]

Net holdings of Sovereign Debt by the bank in proportion to their equity and own resources (EBA tiers 1)

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This table shows that the net exposure of the Belgian banks is by far the highest in the European Union with an average ratio of own resources to Sovereign-debt at 424%, leading second place Cyprus at 341% by a good distance, before Germany (306%) and Italy (304%). [11]

Attention, if we compare the volume of derivatives and other structured financial products that are entered into the balance-sheet we would find ratios that are even higher and, as such, that much more worrying. [12] These are the real dangers for the banks, dangers they maintain themselves.

It remains true, that purchases by banks in government securities increased following the ECB LTRO policy.

Although in 2010-2011, the governments and the ECB lied to public opinion when claiming that the cause of the banks' problems had their origins in the doubtful capacity of countries, such as Greece, to pay their debts. ECB policies created the conditions that brought the banks towards buying large quantities of sovereign debt, including

that of peripheral countries. When the next crisis strikes we can be sure they will be telling the same old stories, claiming that public debt is the cause of the banks', and the economy's problems.

Translation : CADTM

[1] This situation is explained here Ce dispositif est à mettre en relation avec la pondération des actifs par le risque qu'ils représentent. J'ai expliqué cela dans <http://cadtm.org/Banks-bluff-in-a-completely-legal> published on 4 July 2013; <http://cadtm.org/Banks-Fudged-health-report> published on 6 August. See also the soon to be published book, *Bankocracy*, Merlin press, London 2015.

[2] *Financial Times*, 'Banks plot early repayment of ECB crisis loans', 15 November 2012, p. 25.

[3] According to the Spanish financial daily *El Economista*, 'La deuda del Estado en manos de la banca se duplica en siete meses' ('Government debt held by banks doubles in seven months'): <http://www.eleconomista.es/espana/noticias/4252377/09/12/La-deuda-del-Estado-en-manos-de-la-banca-se-duplica-en-siete-meses.html> (in Spanish).

[4] See <http://www.bloomberg.com/quote/GSPG10YR:IND> consulted on 18 November 2014.

[5] *Financial Times*, *ibid.*

[6] Banca d'Italia, *Supplements to the Statistical Bulletin: Monetary and Financial Indicators* "Money and Banking, November 2012, http://www.bancaditalia.it/statistiche/stat_mon_cred_fin/banc_fin/pimsmc/pimsmc12/sb58_12/en_suppl_58_12.pdf, Table 2.1a.

[7] See <http://www.bloomberg.com/quote/GSPG10YR:IND> consulted on 18 November 2014.

[8] Nevertheless, during 2012-2014, Italian and Spanish authorities were forced to recapitalise several big banks, as were Austria, Cyprus, Greece, Ireland, the Netherlands and Portugal.

[9] See <http://cadtm.org/To-the-Bankers-He-s-Super-Mario-2>

[10] "These statistics demonstrate the total exposure of each national banking system to sovereign debt, regardless of their country of issue. It is particularly instructive to compare these positions to the total level of capital of the banks concerned." In Eric Dor, 'Belgian banks are European champions in exposure to sovereign risk, November 5, 2014

[11] See the article by Eric Walravens of the Belga agency, '« Belgian banks are European champions in exposure to sovereign risk », November 5, 2014 (In French)

[12] See, Eric Toussaint, *Bankocracy*, Merlin, 2015.