Benoît Cœuré: Financing the economy of the euro area – the European Central Bank's role

Speech by Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, at the Association Française des Tresoriers d'Entreprises (AFTE), Paris, 11 April 2012.

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I wish to thank Simone Manganelli for his contributions to the speech. I remain solely responsible for the opinions contained herein.

Ladies and gentlemen,

It is a pleasure for me to be here at the Association Française des Trésoriers d'Entreprise.

The topic I have chosen for my address today is the role that the ECB has played – and will play – in ensuring that the real economy of the euro area continues to receive the funding it needs to function properly and how this is linked to the ultimate objective of maintaining price stability in the medium term. I will focus in particular on the latest round of non-standard measures – the three-year refinancing operations which were conducted in December and February. I will start by describing the risks that the euro area economy was facing in the last quarter of 2011. At that time the banking system had funding difficulties, and we were on the brink of a credit crunch. If a crunch had occurred, it could have had devastating consequences for many firms and households; their access to financing would have been restricted. I will then describe how the injection of long-term liquidity has helped to avoid a sudden curtailment of financing to the private sector by alleviating funding pressures on the banking system. I will go on to consider some of the challenges the Eurosystem is likely to face in the near future.

Credit developments to households, non-financial corporations and small and medium-sized enterprises (SMEs)

During the last quarter of 2011, monetary and credit developments to the private sector were exceptionally weak. The annual growth rate of monetary aggregates declined significantly in December, and it was mirrored by similar developments in lending to the private sector, especially loans to households and non-financial corporations. Clearly, as the sovereign crisis intensified it impeded banks' support for the real economy.

The annual growth rate of banks' credit to the private sector decreased in the last quarter of 2011, reflecting monthly negative outflows and reaching troughs comparable with those prevailing in 2008–2009. In particular, the rate of growth of loans to households declined, reflecting both demand-side factors (such as a deterioration in the prospects for the economy, and notably the housing market) and supply-side factors (such as increasing funding difficulties for banks) (Slide 1). Incidentally, these developments masked significant cross-country heterogeneity, as some countries saw an increase in flows supported by government measures aimed at the housing market. The annual growth rate of loans to non-financial corporations declined as well, reflecting particularly weak quarterly flows (Slide 2). There was considerable cross-country heterogeneity in this case too, with net redemptions taking place mainly in certain countries and loans to non-financial corporations continuing to grow in others.

The worrisome picture of monetary developments was confirmed by the results of the Bank Lending Survey for the fourth quarter of 2011. Euro area banks tightened credit standards compared with the previous quarter for both loans to non-financial corporations and loans to households, and to a lesser extent for loans for consumer credit. Furthermore, survey participants expected a further tightening of credit standards in the first quarter of 2012. Even

if the tightening was slower than during the 2007–2008 financial turmoil, it was starting from considerably tighter credit standards.

Although it is always tricky to disentangle supply-side from demand-side factors, banks explained their changes in credit standards mainly by primarily referring to increased funding costs and balance sheet constraints, which were compounded by a rapidly deteriorating economic environment. The funding situation of euro area credit institutions worsened noticeably in the second half of 2011, as shown by the rise in withdrawals of deposits held by non-euro area residents with euro area banks and difficulties in issuing longer-term debt securities. This caused banks to make greater recourse to Eurosystem operations.

The decline in credit to the private sector was accompanied by an increasing reluctance on the part of the euro area private sector to invest in financial assets; it severely hampered banks' access to financing via the secured money market, due to an increase in haircuts and a deterioration of the available collateral.

While market-based funding was becoming ever scarcer for banks in the euro area (as investors were growing increasingly nervous about the escalation of the sovereign crisis), banks were also facing regulatory and market pressures to strengthen their capital position.

In short, back in December 2011, even though there was significant cross-country heterogeneity, the overall picture was rather gloomy. There were clear signs that supply-side factors were making banks less willing to lend to the non-financial private sector, and that banks may have entered a vicious circle which could compromise their ability to supply credit to the economy, both in the short and the long run. The additional negative impact on banks' balance sheets of rapidly declining sovereign bond prices made the situation even worse.

Banks typically have three ways to adjust to pressures on their funding and capital positions: they can sell assets, raise capital or reduce lending. Let's look at each of these options in turn.

In an environment of extreme uncertainty and high risk aversion, risky assets can only be disposed of at very low prices, possibly considerably below their book value. Fire sales would weigh on profits, further deteriorating banks' capital positions, generating in the process negative externalities and sub-optimal collective behaviour. Therefore, to be successful, significant reductions on the assets side of the banks' balance sheet require a stabilisation of the economic and financial environment.

Raising capital is also challenging in an unstable environment. Uncertainty about the pricing of the risky assets and the overall risk surrounding the valuation of banks makes it particularly difficult to attract new equity investors. Raising capital in such circumstances may not be accepted by shareholders as it may send a negative signal to the markets and lead to a drop in share prices. And, compared to 2008–2009, credible government support for banks' capital positions was less available.

This left banks with the third option, namely, to reduce lending. Banks could easily stop rolling over their loans or granting new ones. This strategy, however, while optimal from an individual bank's perspective, would lead, if pursued collectively, to a credit crunch, with significant negative consequences on the real economy and additional strains on the banking sector.

A credit crunch would have been particularly dangerous for small and medium-sized enterprises (SMEs), given their heavy reliance on bank funding. It is no exaggeration to say that SMEs form the backbone of Europe's economy, accounting for approximately two-thirds of employment. Let me give you a few statistics: SMEs constitute about 99% of all firms in the euro area, employ 72% of the euro area's labour force and generate around 60% of value added. They have significantly higher gross job creation (and destruction) rates than large enterprises. At the same time, SMEs tend to face more stringent financial constraints, have a higher cost of external finance and exhibit higher debt levels than large firms. According to the most recent survey on SMEs conducted by the Eurosystem, in the second

and third quarter of 2011 access to finance remained one of their most pressing problems. To put things into perspective, bear in mind that the number of firms concerned about financing was actually lower in 2009, a period when economic activity in the euro area was very weak. According to the survey, bank financing (via overdrafts, credit lines and bank loans) remained the most important source of external financing for SMEs. In addition, 20% of the respondents perceived a further decline in banks' willingness to provide loans. Therefore, after the improvement registered in 2010, SMEs were experiencing once again significant constraints in obtaining financing.

In the light of this evidence, the concrete risk that the increasing pressures on banks' funding and capital positions could lead to a significant curtailment of banks' lending activity in some countries was judged to be extremely high in December 2011. In particular, a dangerous loop involving low economic activity, funding stress for banks and a reduction in lending had increased the downside risks to price stability. It was therefore a top priority to break this loop before it spiralled out of control.

Launch of new non-standard measures and their impact

Faced with this critical situation, the Eurosystem adopted a two-pronged strategy. First, it offered ample liquidity at very long maturity to prevent funding issues from igniting a potentially destructive deleveraging process. Second, it widened the eligible collateral to facilitate access to the liquidity and the provision of credit to SMEs.

Specifically, on 8 December 2011, the ECB announced the following initiatives.

First, the ECB said it would launch two longer-term refinancing operations (LTROs) with a maturity of 36 months. The LTROs were to be conducted as fixed-rate tender procedures with full allotment, with the interest rate fixed at the average rate of the main refinancing operations over the life of the respective operation. To increase the flexibility of the operations and to cater for different liquidity needs, counterparties were offered the option to repay after one year any part of the allotted amounts.

Second, the ECB decided to increase collateral availability by allowing national central banks, among other things, to accept as collateral additional performing credit claims (i.e. bank loans) that satisfy specific eligibility criteria. As an example, the Banque de France has accepted real estate residential loans with a mortgage or first-rank privilege, credit claims denominated in US dollars and export credit claims guaranteed by Coface. Also, in addition to the ABSs that were already eligible for Eurosystem operations, the ECB would accept as eligible collateral ABSs with a second best rating at issuance and over the lifetime of A- or above, the underlying assets of which comprise residential mortgages and loans to SMEs. Additional credit claims not complying with the regular minimum credit quality threshold applied to collateral eligible for Eurosystem credit operations are subject to increased haircuts to aim at achieving risk equivalence with the regular set of eligible collateral.

The Eurosystem allotted €489 billion with the first three-year LTRO on 21 December 2011. Accounting for other operations that matured and settled within that week, however, the net liquidity increase was €210 billion. In the second three-year LTRO, on 29 February, the Eurosystem provided credit institutions with an additional gross amount of €530 billion. Again, taking into account maturing operations, the net liquidity injection was around €311 billion. Counterparties bidding in the three-year LTROs can be divided into two groups: one group consists of many small banks, bidding for comparatively small amounts, while the other group comprises large banks and accounts for the main share of the overall allotment amount. A distinctive feature of the second operation was the higher number of bidders, 800, as opposed to 523 in the first operation. The majority of bidders in the second LTRO were small banks from euro area countries where the economic conditions are stronger, with more than half of the bidders bidding for €50 million or less. A reasonable interpretation of this outcome is that the Eurosystem has also been successful in reaching smaller financial

entities, which had more time to prepare their bids in the second operation than in the first, and which are essential for providing credit to SMEs.

Analysis of the main determinants of banks' bidding behaviour, combined with anecdotal information provided by banks, confirms that the funding issues I referred to earlier were of vital importance. As an illustration, Slide 3 shows a positive relationship between spreads on bank bonds at issuance and the amounts bid by banks in both three-year LTROs as a percentage of their total assets. The slide suggests that, for those banks with access to longer-term funds in the bond market, there was a strong correlation between their cost of funding and their bidding behaviour. Banks without outstanding debt securities bid on average even more aggressively. Overall, our internal analysis shows that the most aggressive bidders were characterised by larger amounts of debt maturing in the next three years and a shorter average maturity of the outstanding debt. The results of the Bank Lending Survey further reinforce this interpretation.

This evidence supports the Governing Council's view that banks were facing significant funding problems and that, by removing impediments to their ability to finance the real economy, the three-year LTROs helped to avoid a dangerous credit crunch in the euro area.

The large injection of liquidity via the three-year LTROs had an immediate impact on many market segments. By reducing concerns over the liquidity situation faced by banks and by cutting banking sector systemic risk (which is reflected, for instance, in a sharp decline in EU bank CDS premia), the LTROs contributed to reopening funding markets.

In money markets, the EURIBOR-OIS spreads have reversed their widening trend from last year, by narrowing substantially, thereby suggesting that the operations have successfully lowered risk premia. More generally, the whole euro money market curve has flattened. In the secured segment, repo rates in selected euro area government bonds, which had been progressively increasing since August 2011 compared with those based on collateral from AAA countries, declined and continued to remain low, indicating that the funding of Italian and Spanish government bond positions in the repo market has become much cheaper. Although turnover in the repo market has remained relatively subdued, there are signs of a moderate pick-up in the volume in Spanish and Italian markets from their levels at the end of 2011. The widespread perception of lower liquidity risk and improved capital adequacy thanks to the European Banking Authority capital exercise also brought a welcome reduction in US dollar funding costs via the FX swap market. US prime money market funds increased their exposure to euro area banks in January 2012 for the first time since April 2011, with an additional increase of 21% between the end of January and mid-March, and exceeding 12% of total assets under management.

Euro area banks' issuance of medium and long-term debt picked up in the first two months of 2012 compared with the subdued levels in the second half of 2011. In this period, euro area banks issued about €50 billion in senior unsecured debt, which is about as much as was issued in the entire second half of 2011. Banks also issued €35 billion in covered bonds. While term debt issuance was mostly concentrated in some AAA euro area countries in the early phase of market reopening, the issuer base broadened thereafter. In particular, February saw the issuance of senior unsecured debt by some large banks from Italy and Spain, as well as some increased covered bond issuance by large banks and new issuance by "second-tier" lenders from these countries.

In another sign of improving funding conditions, the cost of medium and long-term funding has decreased since December 2011, as illustrated by the drop in European debt yields for financial and non-financial corporations (Slides 4 and 5). Unsurprisingly, the change in yields was particularly pronounced for the lower-rated bonds, confirming that the LTROs have managed to sharply reduce risk premia. The resulting perception that liquidity risks for euro area banks have diminished and that capital adequacy has improved thanks to the capital exercise might also have contributed to the recent strong performance of the stock markets of many euro area countries (Slide 6).

Euro area sovereign bond markets have rebounded dramatically. Yields of shorter-term notes and bills have declined, with two-year government bond yields of Italy, Ireland and Portugal declining by over 400 bps since 8 December 2011. Longer-term government yields have declined as well, although not to the same extent as shorter-term yields (Slide 7). The positive secondary market developments were accompanied by favourable primary market activity with sustained demand in auctions of T-bills and shorter bonds in several euro area countries.

All in all, there is now strong preliminary evidence that the three-year LTROs have helped the banks to reduce liquidity risk and therefore allowed them to smooth the deleveraging process over a longer period of time and maintain exposures to SMEs – at least in some cases. Anecdotal evidence also points to the return of some institutional money market investors, with quite a number of banks reporting that funds (also unsecured) are becoming available again at somewhat longer maturities. While banks seem to have used the funds obtained from the first three-year LTRO mainly for refinancing purposes, when looking forward to the next six months, they now seem to expect a stronger use of these funds for granting loans. Whether these expectations will materialise remains an open question and the Governing Council will closely monitor these developments.

Challenges ahead

A side effect of the three-year LTROs is that the banking system in the euro area is now in a situation of abundant excess liquidity. "Excess liquidity" (defined as the difference between outstanding open market operations and the liquidity needs from autonomous factors and reserve requirements) currently stands at around €800 billion and is expected to remain at roughly this level at least until the end of January 2013, when banks will be able to exercise the option of early repayment on the first three-year LTRO. The leeway for a reduction in outstanding refinancing operations before that date currently amounts to around €100 billion, and the scale on which banks will exercise early repayment options is difficult to anticipate at the current juncture. As a consequence, the balance sheet of the Eurosystem has grown to €3 trillion. This large increase is a symptom of malfunctioning money markets and reflects the fact that the Eurosystem has replaced much interbank activity. When the situation stabilises and money markets go back to functioning normally, the balance sheet of the Eurosystem will also go back to its normal size. To this respect, the Eurosystem is often compared with other major central banks. Such comparisons however disregard the initial size of balance sheets, as the Eurosystem holds a large volume of assets that have nothing to do with monetary policy. In early March, the ratio of monetary policy instruments to regional GDP was 15% for the Eurosystem, 19% for the Federal Reserve System and 21% for the Bank of England.

This large amount of excess liquidity has drawn criticism of two different kinds. Some observers have argued that since banks are re-depositing with the ECB large amounts of liquidity, the injected liquidity is not circulating within the system and therefore the ECB's actions will be ineffective in preventing deflationary pressures. Others, however, have warned that since these large amounts of excess reserves may remain in the system for a relatively long time, if they are not appropriately absorbed they will hamper the ECB's ability to keep inflationary pressures in check. These fears are of course contradictory. In order to dispel them, let's look more closely at the channels of transmission through which the excess liquidity circulates in the system.

The first criticism – that large-scale use of the deposit facility demonstrates the ineffectiveness of ECB's measures – reflects a fundamental misunderstanding of the functioning of the operational framework of the ECB. By an accounting identity, any amount of liquidity injected in excess of the liquidity needs of the banking system will be necessarily re-absorbed via the deposit facility. The increase in the deposit facility does not provide any information whatsoever about how banks use the funds borrowed from the central bank.

For instance, a bank which has borrowed from the ECB can use the funds to grant a mortgage to a client, who in turn uses that credit to pay construction workers, who in turn may buy a car, and so on. After each transaction, the buyer transfers the amount from his or her bank account to the seller's bank account. The liquidity can circulate many times before eventually appearing on the balance sheet of a bank with a liquidity surplus, which will be deposited back with the ECB. Of course, at the other extreme is the bank which borrows from the ECB and immediately deposits the amount with the central bank. In this case, the liquidity did not circulate at all.

In both cases, the amount deposited with the ECB would be exactly the same and it is therefore wrong to assume from the large use of the deposit facility that the liquidity is not circulating. In fact, we know that the banks which are depositing with us are not the same as those which are borrowing, indicating that the liquidity is somehow circulating within the banking system before coming back to us. We have no information however (besides anecdotal evidence) about the speed at which this liquidity is circulating, and through which channels.

Let me turn now to the second criticism – namely that excess liquidity will generate inflation. It is important to recall, first, that the three-year LTROs have helped avoid a disorderly deleveraging which may have led to deflation. Let's analyse now the arguments behind the fear that the LTROs may have, however, increased the upside risks to price stability. Central bank reserves represent one of the many assets in the balance sheet of a bank. Up to a certain amount, banks' demand for central bank reserves is completely inelastic (due to central bank reserve requirements, internal and external liquidity regulation and other factors). Beyond this amount, however, the decision to hold excess reserves responds to risk-return considerations as for any other asset: if a bank decides to hold a certain amount of excess reserves, it is because their risk-adjusted return dominates that of other assets.

As I mentioned earlier, while an individual bank can decide to hold less excess reserves, in the short run the banking system as a whole cannot dispose of excess reserves. Since, in equilibrium, supply must equal demand, if interest rates on central bank deposits (the risk-free remuneration of excess reserves) are at levels such that demand for reserves exceeds supply, banks will be willing to hold on to the excess reserves present in the market. This is likely to be the case in a situation of high risk aversion, where – like today – the risk premia demanded to hold risky assets are so high that their risk-adjusted return is lower than that offered by the deposit rate.

If, however, banks become more willing to accept risks, their demand for excess reserves for a given deposit rate will decrease and they will look for more attractive alternative uses for these funds: riskier assets and/or loans. Since the banking system as whole cannot return to equilibrium (after the three-year LTROs, the supply of reserves is inelastic in the short term), this behaviour will put pressure on asset prices and (as soon as the economy reaches its full potential) on consumer prices as well, unless an appropriate monetary policy stance is taken.

These effects and the speed at which they may materialise are difficult to quantify as cases of protracted periods of excess liquidity have been rare in the past. The experience of Japan does not suggest direct effects on inflation. In the United Sates and United Kingdom, there is also no clear-cut evidence so far of a pick-up in monetary and credit aggregates spurred by excess liquidity. However, it is fair to say that in case of a sustained and more robust recovery in economic activity, excess reserves may have a potential macroeconomic impact by allowing a build-up of significant asset price misalignments, or by distorting the banks' incentive to supply funding to the economy. Moreover, in the face of asset market fragmentation, such asset price misalignments are more likely to build up in countries where banks have ample liquidity positions.

There is nothing, however, in this reasoning that prevents the ECB from tackling these effects by increasing policy rates, whenever the Governing Council deems it necessary to do so. Our operational framework makes it possible to steer a whole range of money market

rates in line with the desired monetary policy stance. In fact, if the ECB decides to the change its key policy rates, or even hints at it, the indexation of the interest rate charged on our refinancing operations will immediately affect present and future funding conditions for banks, favouring inter alia the exit of some of the LTRO bidders. Furthermore, in our corridor system, the deposit rate puts an effective floor under short-term unsecured money market interest rates.

Higher interest rates will reduce demand for loans, as the net present value of the project of the marginal investor becomes negative. Higher interest rates will also decrease the demand for risky assets, as the remuneration of risk-free assets increases. Eventually, for sufficiently high interest rates, inflationary pressures will subside and the system will return to equilibrium.

It can still be argued that there is significant uncertainty as to how an environment of abundant excess liquidity affects the transmission mechanism of monetary policy. In particular, heterogeneity in the economic conditions of euro area countries may be magnified by the excess liquidity, which tends to flow to countries where the economic conditions are stronger. However, should this uncertainty weaken our ability to maintain price stability, the ECB has the necessary instruments to absorb the excess liquidity. In this respect, it is worth recalling that we have been sterilising the liquidity created with the government bond purchases under the Securities Markets Programme for almost two years. By auctioning weekly fixed-term deposits, the ECB has been successfully absorbing substantial amounts of liquidity. In addition, the ECB has the right to issue debt certificates, and, if necessary, we could also decide to increase banks' reserve requirements again. Reverting to the 2% reserve requirement ratio that prevailed until December 2011 would reduce excess reserves by approximately 100 billion euros. So, we are well equipped to cope with any issues arising from excess liquidity.

There is a third concern which I would like to touch upon, and which I consider to be a serious one: the risk of moral hazard behaviour triggered by the non-standard measures. The large liquidity injections have avoided so far a disorderly deleveraging of the banking sector in the euro area as well as a dangerous credit crunch, but they have not removed the underlying causes of the turmoil. If governments and banks would stop or slow down their consolidation efforts and structural reforms, this would undermine the positive effects of the liquidity operations.

Following the signs of improvement in the financial environment, it is therefore essential for banks to strengthen their resilience further, even by retaining earnings. The soundness of banks' balance sheets will be a key factor in facilitating an appropriate provision of credit to the economy. Very low interest rates and ample liquidity conditions may be disincentives for banks to avoid recognising the loss by rolling over loans extended to borrowers who are unable to pay back the principal (the so-called "evergreening" of loans). It is critical that banks readily exploit the current relatively favourable conditions to meet capital adequacy objectives and improve their funding profile.

Similarly, to promote sustainable growth and to support confidence and competitiveness, governments need to continue their efforts towards restoring sound fiscal positions and improving competitiveness. Many governments have already made significant steps and the efforts must continue unabated.

Finally, a fourth concern relates to the risk of persistent market fragmentation. The ECB has used conventional and non-conventional measures to restore the transmission channels of monetary policy and make sure that the impulse stemming from it is transmitted more uniformly across the 17 economies of the euro area. The large size of the Eurosystem's refinancing operations and the resulting expansion in its balance sheet are a reflection of the impairments which still hamper the proper functioning of capital markets in the euro area. Today, it is of utmost importance to address these impairments, otherwise we will loose the benefits of the freedom of capital movements which was why monetary union was needed in

the first place. There will be no lasting recovery of growth if European households and corporations cannot tap a common pool of savings.

To operate smoothly, be more resilient to crises and better support long-term growth, Economic and Monetary Union has to become a true financial union. I will list here some of the key features of the much-needed "Financial Compact". Repairing the single market for capital is a collective endeavour in which the ECB has a role to play – but to be fully effective that role needs to be coordinated with the European Commission, European Supervisory Authorities and market participants themselves. Breaking the feedback loop between bank and sovereign credit should also be a priority. To this effect, steps should be taken towards a unified regime for bank resolution and beyond that, towards establishing a single European banking resolution authority. Finally, the "Financial Compact" should also include the completion of the single euro payment area.

Payments are at the very heart of a corporate's activity and I am not sure that they always get the attention they deserve. Nowadays, more than 50% of the trade of the 27 EU countries takes place within the EU – and that trade is mainly based on cashless payments. With the introduction of the single currency there could no longer be any differentiation between national and cross-border euro payments: they should all be "domestic". The Single Euro Payments Area project, in short "SEPA", came to fill this void; its aim is to establish a single market for retail cashless euro payments by overcoming technical, legal and market barriers, so that people can make euro payments throughout Europe as easily, securely and efficiently as within their own countries.

Using the SEPA payment instruments, companies can make all euro-denominated payments centrally, from a single account, using the same format. This opens up the possibility of consolidated payments, of liquidity management in one location and of optimising the cash flow. The European Commission has stepped in with the Payment Services Directive which, among other changes, ensures that the full amount of a transaction is transmitted and that payments are executed more quickly, thus saving time and money. As the transition to SEPA had to speed up, the European Council adopted in February 2012 a new regulation establishing 1 February 2014 as the deadline for the migration to SEPA of credit transfers and direct debits made in euro. This means that users, including corporates, need to migrate too! SEPA is also about innovation; the project is active in innovative fields such as e-invoicing and e-reconciliation within Europe, which can offer huge savings for corporates in the handling of payments. The ECB, in its role as a co-chair of the SEPA Council together with the European Commission, stands ready to pursue a dialogue with all stakeholders on these important matters.

Conclusion

Let me to bring my remarks today to a conclusion. In the last quarter of 2011 the euro area economy was facing increasing cross-countries heterogeneities and, overall, a clear risk of a credit crunch. The increasing pressures on banks' funding and capital positions could have led to a scaling-back of banks' lending activity to the private sector. The result could have been a vicious cycle involving low economic activity, increased funding stress for banks and a further reduction in lending, eventually leading to significant downside risks to price stability. The actions of the ECB have helped to break this cycle and to bring confidence back into the euro area financial system.

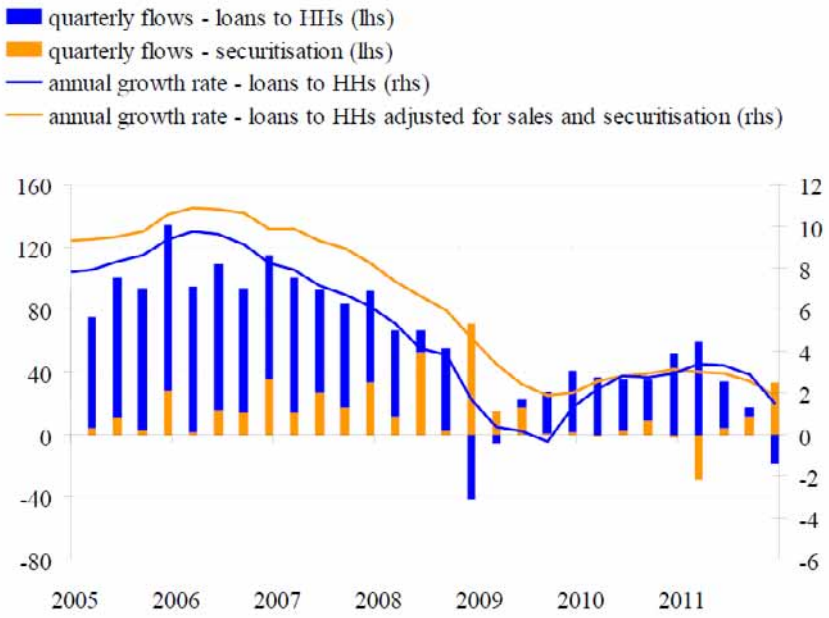
The large amount of liquidity now present in the system is a consequence of these actions. It represents the symptoms of a malfunctioning interbank market, which, if left untreated, could have led to a credit squeeze. The ECB's ability to maintain price stability remains intact: we will have the possibility to adjust the interest rates and, if necessary, we have at our disposal a range of tools to actively absorb the excess liquidity.

The ECB has addressed the immediate symptoms, but monetary policy cannot cure the underlying causes. The situation in financial markets has reached a turning point but recent market developments have highlighted that it remains fragile. All the relevant players must act responsibly by taking the necessary steps. Banks need to meet capital adequacy objectives, improve their funding profile, and start lending again. Governments must build on the steps already taken to restore sound fiscal positions and support long term growth. At the ECB we will continue to closely monitor further developments. We will do whatever it takes to fulfil our mandate of delivering price stability over the medium term for the 330 million people of the euro area.

Thank you for your attention.

MFI loans to households

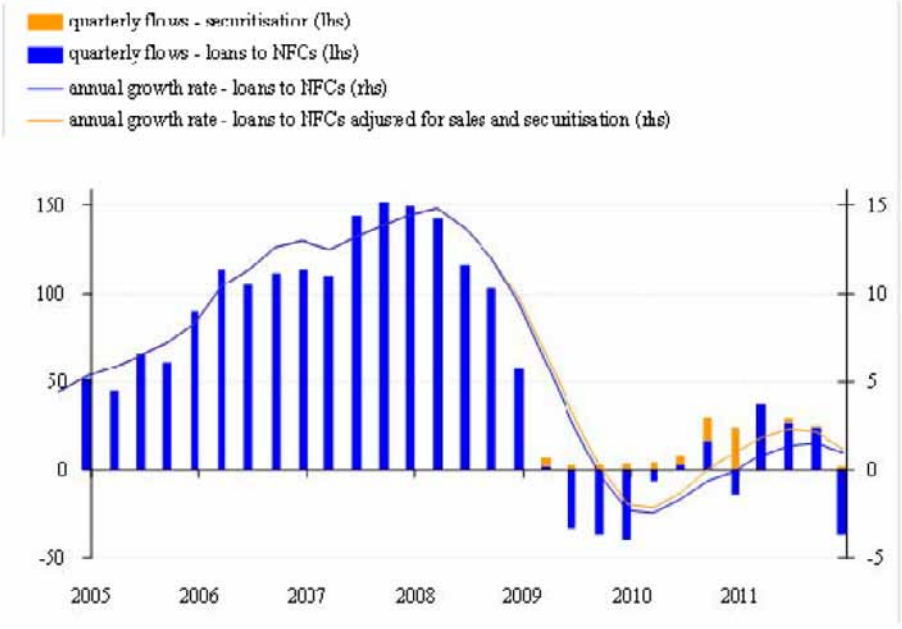
(annual percentage changes; flows in EUR billions, adjusted for seasonal and calendar effects)



Source: ECB

MFI loans to non-financial corporations

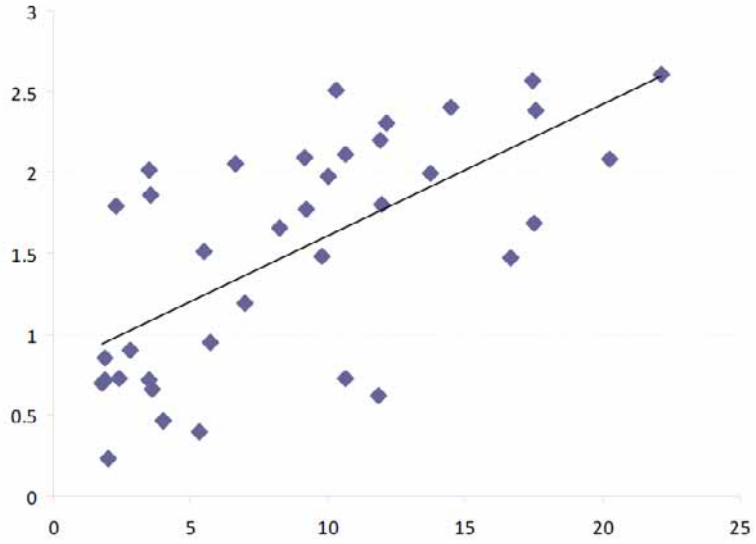
(annual percentage changes; flows in EUR billions, adjusted for seasonal and calendar effects)



Source: ECB

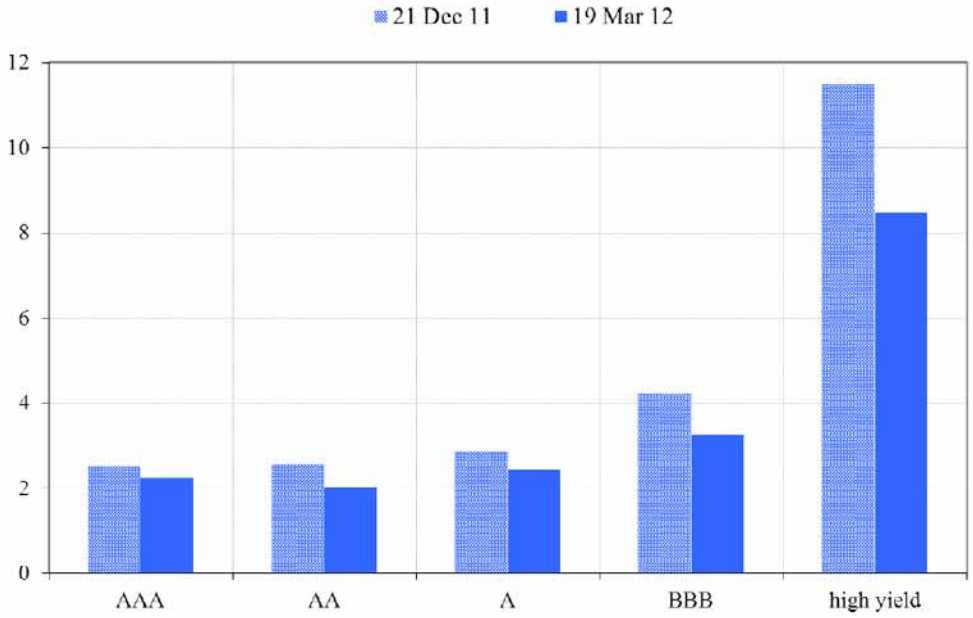
Banks' risk premia and bidding behaviour
(for banks with market access in 2011)

y-axis: spreads over mid-swap rates at issuance for long-term debt in 2011 in percentage points
x-axis: amounts bid in both three-year LTROs as a percentage of total assets



Sources: ECB, Fitch Ratings and DCM Dealogic

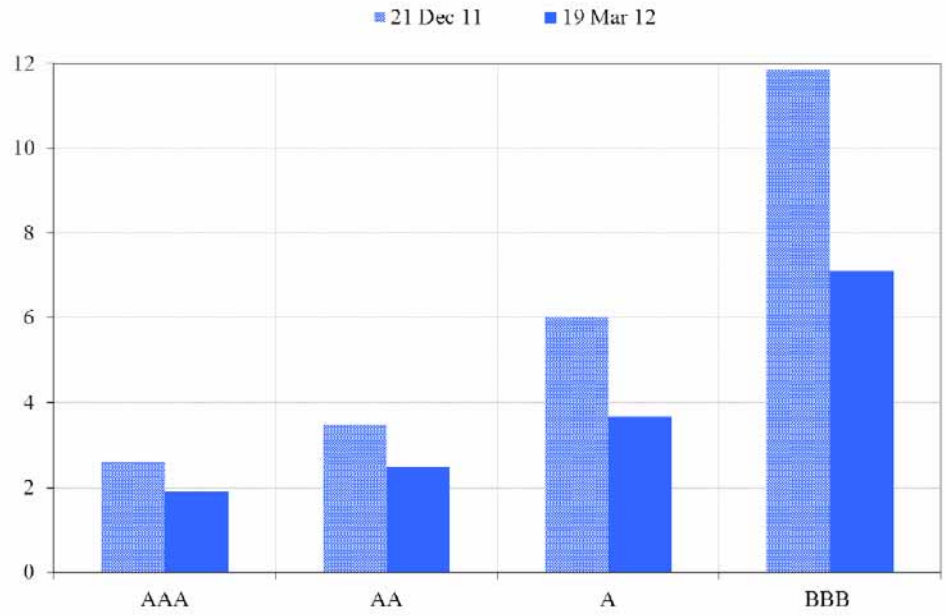
Debt yields for non-financial corporations
(percentages per annum)



Source: Datastream, Merrill Lynch Index, all maturities

Debt yields for financial corporations

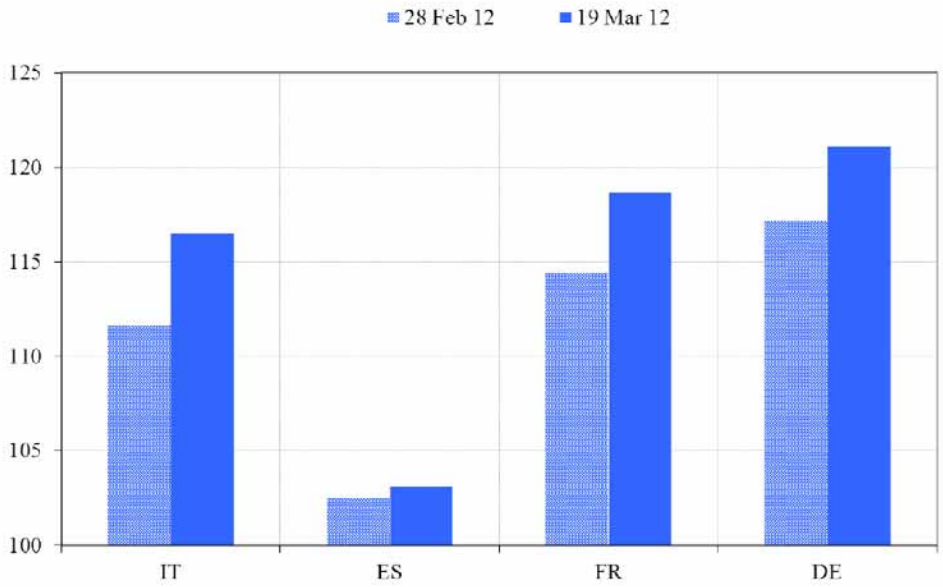
(percentages per annum)



Source: Datastream, Merrill Lynch Index, all maturities.

Developments in equity index

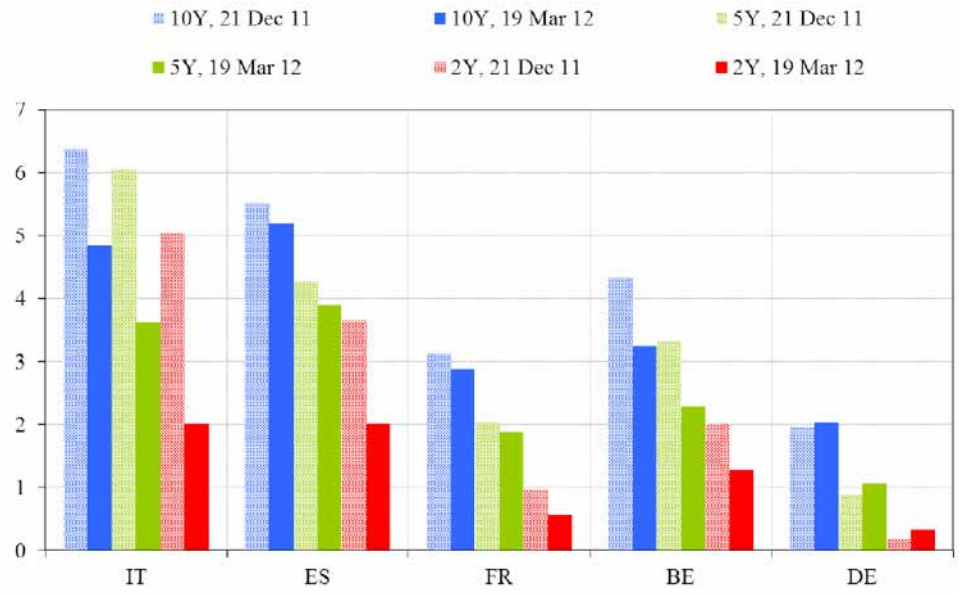
(index points)



Note: Rebased to 100 on 21 December 2011
Source: Total market index calculated by Datastream.

Government bond yields

(percentages per annum)



Note: Generic government bond yield
Source: Datastream.