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ECB eyes exit for €40bn crisis fund

209 74

By Ralph Atkins in Frankfurt and Mary Watkins in London

The European Central Bank is falling behind on a €40bn asset purchase programme launched at the height of eurozone crisis, in a sign it could be dropped as a first step towards unwinding huge emergency support for the region's financial system.

Purchases of "covered bonds" – debt backed by pools of assets favoured by some institutional investors – have so far totalled less than €9bn. The scheme started last November and was originally intended to run until October at the latest.

The shortfall largely reflects improved market conditions, but comes amid discussions at the ECB over an "exit strategy" by which the central bank would wean eurozone banks off its exceptional financial support.

Ending the covered bond purchases, or scaling back their scope, would signal that the ECB was determined to return to more conventional monetary policy tools as soon as possible. The programme predates the ECB's exceptional offers of unlimited three-year loans in December and February, when it injected more than €1tn into the eurozone banking system.

Recent public comments by members of the ECB's 23-strong governing council have confirmed that discussions have started on an exit strategy – although no decisions have been taken on details or timing. ECB policy makers fear delays in exiting would distort financial markets, discourage eurozone governments from implementing reforms and create inflation dangers.

With the eurozone crisis still at risk of reigniting, the ECB will proceed cautiously. The bruising experience in early 2010 when an attempt to implement an exit strategy was thrown into reverse by the eruption of the Greek debt crisis remains on policy makers' minds.

But the improvement in financial market confidence following the €1tn provided in the three-year longer-term refinancing operation (LTRO) means the covered bond programme is no longer seen as necessary in Frankfurt, and its future has already been discussed by the governing council.

The ECB said it had no comment.

Heiko Langer, senior credit analyst at BNP Paribas, said: "The LTRO has made the covered bond purchase programme a little obsolete. The ECB is not making much use of it and, assuming an average amount is bought over the 12-month term, the bank is running 50 per cent behind where it should be for the year."

In testimony to Congress on the eurozone crisis, Ben Bernanke, the Federal Reserve chairman, said that lower financial stress in Europe was a "welcome development for the United States".

But he warned that Europe was not safe yet and there was more work to be done: "Europe's financial and economic situation remains difficult and it is critical that the European leaders follow through on their policy commitments to ensure a lasting stabilisation."

In recent weeks, Mario Draghi, who took over as president on November 1, has suspended the ECB's controversial government bond purchasing programme, which was opposed by Germany's Bundesbank.

Subsequent steps in an exit strategy could include the ECB mopping up excess liquidity from the eurozone financial system by taking deposits from banks or issuing bills. It could also raise borrowing costs by increasing its main policy interest rate or by driving up market interest rates. The eventual aim would be to return to the pre-crisis system of auctioning liquidity, rather than meeting in full banks' demands.

The decision to launch the covered bond buying programme was one of the last taken by Jean-Claude Trichet, the previous ECB president. At the time, the Greek crisis was affecting the ability of banks to issue both senior unsecured debt and covered bonds.

Under a similar covered bond buying programme launched by the ECB in 2009, purchases – which totalled €60bn – were spread evenly over the year of its operation. If the ECB had adopted a similar buying strategy under the latest €40bn scheme, purchases after five months should have reached roughly €17bn. Instead, the total covered bonds acquired as of Tuesday night was just €8.7bn.

Armin Peter, head of covered bonds at UBS, said that at the time of the ECB's 2009 covered bond programme there was a strong need to support Europe's primary and secondary markets and allow banks access to funding. But Mr Peter said he would "not be surprised if the ECB thought about winding down the latest programme, given the performance of the covered bond market post-LTRO".

A quiet phasing-out or even official announcement to close the programme would demonstrate that the ECB had an exit strategy for instruments used to support markets during the crisis.

Additional reporting by Claire Jones in Frankfurt and Robin Harding in Washington

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