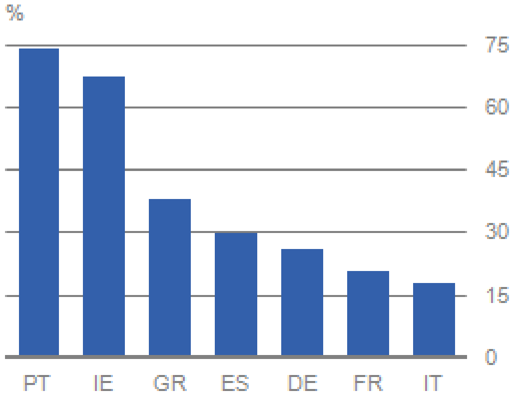
Chart in focus

SME financing in the euro area: The impact of TLTRO

December 9, 2014

On Thursday, the ECB is going to conduct the second of its targeted longer-term refinancing operations (TLTROs) to unlock bank lending in general and to ease the access-to-finance problems of SMEs in particular. To what extent TLTROs will be able to revitalise bank lending to SMEs may depend mainly on i) banks' demand for TLTROs, ii) their intended use of the funds and iii) the importance of SME lending for banks' business as a whole.

SME loans to total business loans



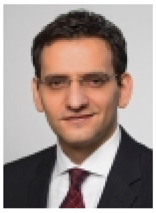
Sources: OECD, Bundesbank, Deutsche Bank Research

In a nutshell, TLTROs aim to increase the flow of funds to the private sector by injecting liquidity into banks' balance sheets. In this respect, success will first of all depend on banks' appetite for TLTROs. According to the Bank Lending Survey (BLS), 44% of the surveyed banks participated in the first tranche in September (47% expected for December). However, September volumes remained well below the EUR 400 bn on offer from the ECB, with banks borrowing only EUR 83 bn. By and large, the ongoing deleveraging and higher capital requirements may limit banks' ability to expand their balance sheets. In addition, before taking up more liquidity, some banks may have waited for the completion of the ECB's stress test, whose results were broadly encouraging in the end. As a consequence, even though the second tranche on Thursday will probably attract higher demand, the aggregate take-up is unlikely to reach the total on offer from the ECB.

How do the banks intend to deploy the additional funding? Around 60% of the banks surveyed in the BLS cite profitability as their enrolment motive. Besides, a substantial 67% want to use TLTRO funds for granting loans to non-financial corporations. These figures, which appear promising at first glance, may mask substantial viability issues, though. Indeed, lending to SMEs is associated with higher risk weights and therefore higher capital charges for banks compared to many other types of assets. Against this background, banks that are still capital-constrained (medium-size and smaller institutions probably more so than the largest banks) may well pass on TLTRO funds to large corporations or use them for alternative, less risky investments instead.

To what extent this will happen also depends on the importance of SME lending for banks' entire business activities. For this, the share of SME loans in total business loans is a good proxy. This ratio is smaller in countries such as Germany (26%) and France (21%), which can primarily be explained by the considerable number of large corporations (and large SMEs which fall outside the rather narrow official SME definition used in Europe) in these countries. Furthermore, in these large and diversified banking sectors, lending to companies in general plays a more limited role compared to other activities, such as international and investment banking operations. Hence, in these cases, the volume of TLTRO funds passed on to SMEs is likely to remain moderate. In other countries such as Portugal (74%) and Ireland (68%), SME shares in corporate lending are much larger and, as a result, TLTROs will probably be more successful.

Please see also: SME financing in the euro area - New solutions to an old problem



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