The ECB’s non-standard monetary policy measures – domestic and global impact

Institutional Challenges for Candidate and Potential Candidate Countries on the Road to the EU and EMU

Joint Vienna Institute Seminar, Vienna, 22 May 2015
Outline

1. Overview of non-standard monetary policy measures
2. Channels of transmission
3. Global impact
ECB standard policy response: key ECB interest rates

((percentages per annum)

Overview of ECB non-standard monetary policy measures

• **Liquidity and funding measures**
  – Fixed-rate tender procedure with full allotment
  – Extension of the maturity of refinancing operations (3y LTRO, November 2011)
  – Expansion of the collateral pool

• **Outright purchases in malfunctioning market segments**
  – Securities Market Programme (SMP)
  – Covered Bond Purchase Programmes (CBPP and CBPP2)
  – Outright Monetary Transactions (OMT, September 2012)

• **Forward guidance** *(as from July 2013)*

• **Credit easing package** *(June and September 2014)*
  – Targeted Long-Term Refinancing Operations (TLTRO)
  – ABS Purchase Programme
  – Covered Bond Purchase Programme

• **Quantitative easing package** *(January-March 2015)*
  – Expanded Asset Purchase Programme (APP)
Impaired pass-through of policy rate cuts to the real economy

ECB policy rate and bank lending rates for short-term NFC loans

Transmission of MRO Rate Reductions to Bank Lending Rates
(percentages per annum)

Post-OMT Easing Cycle (July 2012 – Feb 2015)

20th and 80th percentile range of lending rate changes

MRO rate


20th and 80th percentile range of lending rate changes

MRO rate

Sources: Reuters, ECB calculations.
Notes: Last observation for lending rates February 2015 (left chart), or October 2003 (right chart). The grey ranges define the 20th to 80th percentile of short-term bank lending rates for small-sized loans (<€1mln) to NFCs.
Objective

Forward guidance is an effective tool to manage market expectations of future short-term interest rates more tightly around the desired monetary policy stance, particularly in the face of heightened financial volatility.

Typologies of forward guidance

Calendar-based (date-contingent) versus state-contingent forward guidance
Conditionality referring to explicit quantitative thresholds (e.g. for inflation or unemployment rates) or formulated in broad qualitative terms.

Features of the ECB’s forward guidance

“The Governing Council expects the key interest rates to remain at present or lower levels for an extended period of time. This expectation is based on the overall subdued outlook for inflation extending into the medium term, given the broad-based weakness in the real economy and subdued monetary dynamics.” Fully consistent with the ECB’s mandate and in line with its monetary policy strategy. Adjusted once the effective lower bound of the policy rate was reached.
### Measures

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<th><strong>Rate cuts</strong> (June + September)</th>
<th>June</th>
<th>September</th>
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<tr>
<td>• MRO: 0.15%</td>
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<td>• MRO: 0.05%</td>
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<td>• Marginal lending facility: 0.40%</td>
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<td>• Marginal lending facility: 0.30%</td>
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<td>• Deposit facility: -0.10%</td>
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<td>• Deposit facility: -0.20%</td>
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<th><strong>TLTROs</strong> (June)</th>
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<td>• Fixed at MRO + 10 basis points</td>
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<td>• Max. maturity: Sep. 2018</td>
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<td>• Initial allowance (Sep. and Dec.): 7% of outstanding loans to NFPS</td>
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<td>• Additional allowance (Mar.'15 – June '16): 3 times net lending relative to benchmark</td>
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<th><strong>ABS purchasing programme</strong> (June + September)</th>
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<td>• Preparatory work and adoption of outright ABS purchases</td>
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<th><strong>CBPP3</strong> (September)</th>
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<td>• Purchase broad portfolio of euro-denominated covered bonds issued by MFIs domiciled in EA</td>
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### Objectives

- **Provide additional monetary policy accommodation**
- **Enhance functioning of monetary policy transmission**
- **Support lending to the real economy**
The rationale

Increased likelihood of inflation remaining too low for too long

- Weaker inflation dynamics start influencing marked-based measures of inflation expectations
- Sequence of negative surprises to headline inflation risks to influence price formation in the future

With the lower bound for policy interest rates having been reached, quantitative measures changing the size/composition of the balance sheet remain the only effective tools to achieve further monetary policy accommodation

The objectives

- Underpin a firm anchoring of medium- to long-term inflation expectations
- Contribute to a sustained return of inflation towards a level below, but close to 2% over the medium-term
Purchases comprise securities issued by euro area governments, agencies and EU institutions in addition to the Asset-Backed Securities and covered bonds under the existing programmes.

- Monthly purchases of €60 billion
- Intended until end-September 2016, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with the aim of achieving inflation rates below, but close to, 2% over the medium-term.
- Governing Council controls all design features thus ensuring the singleness of the Eurosystem’s monetary policy; implementation decentralised.
- 20% of additional asset purchases are subject to sharing of hypothetical losses. The rest of NCBs’ additional asset purchases are not subject to loss sharing.
Central banks' balance sheets - total assets
(Index 01 Jun 2006=100)
# Outline

1. Overview of non-standard monetary policy measures
2. Channels of transmission
3. Global impact
Early APP findings: impact on interest rate expectations

Signalling channel: market expectations of future policy rates adjusted downward

EONIA forward rates
(based on EONIA swap rates; percentage per annum)

Sources: Reuters and ECB calculations.
Latest observation: 14 April 2015.
Early APP findings: impact on inflation expectations

Confidence channel: stabilisation of market-based measures of inflation expectations

Medium and longer-term inflation expectations

(percentage points)

Source: Reuters data and ECB calculations.
Early APP findings: impact on financial asset prices

Portfolio rebalancing: broad-based boost to asset prices

10Y government bond yields
(percentage points)

European equity prices
(index points)

Source: Reuters.
Early APP findings: impact on bank credit conditions

Bank lending channel: lower bank funding costs and lending rates

**Composite bank cost of debt financing**  
(percentages per annum)

**Total cost of lending to non-financial corporations**  
(percentages per annum; percentage points)

Sources: ECB, Merrill Lynch Global Index and ECB calculations.  
Notes: Deposit rates (for both retail and institutional investors) and cost of market-based debt financing, weighted using outstanding amounts taken from BSI statistics. An extreme value relating to the collapse of Lehman Brothers in September 2008 has been smoothed out. Latest observation: February 2015.

Source: ECB.  
Notes: The indicator for the total cost of lending is calculated by aggregating short and long-term rates using a 24-month moving average of new business volumes. The cross-country standard deviation is calculated over a fixed sample of 12 euro area countries. Latest observation: February 2015.
Early APP findings: impact on exchange rate

**Exchange rate channel:** triggered by policy stance and portfolio rebalancing

Euro/US dollar exchange rate

*(USD per EUR)*

![Graph showing the exchange rate between USD and EUR from January 2014 to April 2015.](image)

*Source: ECB.*
# Outline

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<td>Overall impact</td>
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The recent inflation and macro landscape in the euro area

Moving in the right direction

Euro area HICP path

Vintages of euro area real GDP growth forecasts for 2015 and 2016

Sources: Thomson Reuters, Eurostat, ECB calculations, Consensus Economics. Last observation: 15 April 2015, March 2015 for HICP.

Sources: World Economic Outlook (IMF), Eurozone Barometer (EB), Consensus Economics (CE), Survey of Professional Forecasters (SPF) and ESCB and ECB staff projections (ECB).

Note: X-axis refers to the date when respective forecast were finalised.
Global announcement impact of the APP

- **Boosted global equity prices (via confidence effects)**
  - In euro area: 1.7%
  - In other advanced economies: 1.1%
  - In emerging economies: 2.2%

- **Caused a differentiated euro exchange rate depreciation**
  - Against advanced economies: -1.35%
  - Against emerging economies: -2.4%

- **Had no clear impact on bond prices outside the euro area**
More sustained global impact of the APP?

• Confidence effects

• Financial market effects

• Real economy effects

• Cross-country heterogeneity of the effects
Concluding messages

The ECB’s mandate (price stability over the medium term) has guided all ECB policy actions, including its non-standard monetary policy measures.

The ECB has a symmetric mandate with a view to upside and downside risks to price stability (inflation below, but close to 2%).

Exceptional circumstances require exceptional measures to live up to the mandate.

At the effective lower band, more monetary policy accommodation needs to be primarily achieved by central bank balance sheet expansion (with forward guidance as an assist).

While the ECB’s APP has been found to have a material impact on inflation and growth in the short run, sustaining this positive impact over time requires all other policy areas to live up to their respective responsibilities.

The global impact of the ECB’s APP is undoubtedly positive, but country circumstances and policies do matter a lot.