EUROPEAN CENTRAL BANK

EUROSYSTEM

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

Frank Moss*

Director General International and European Relations

*Speaking in a personal capacity

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

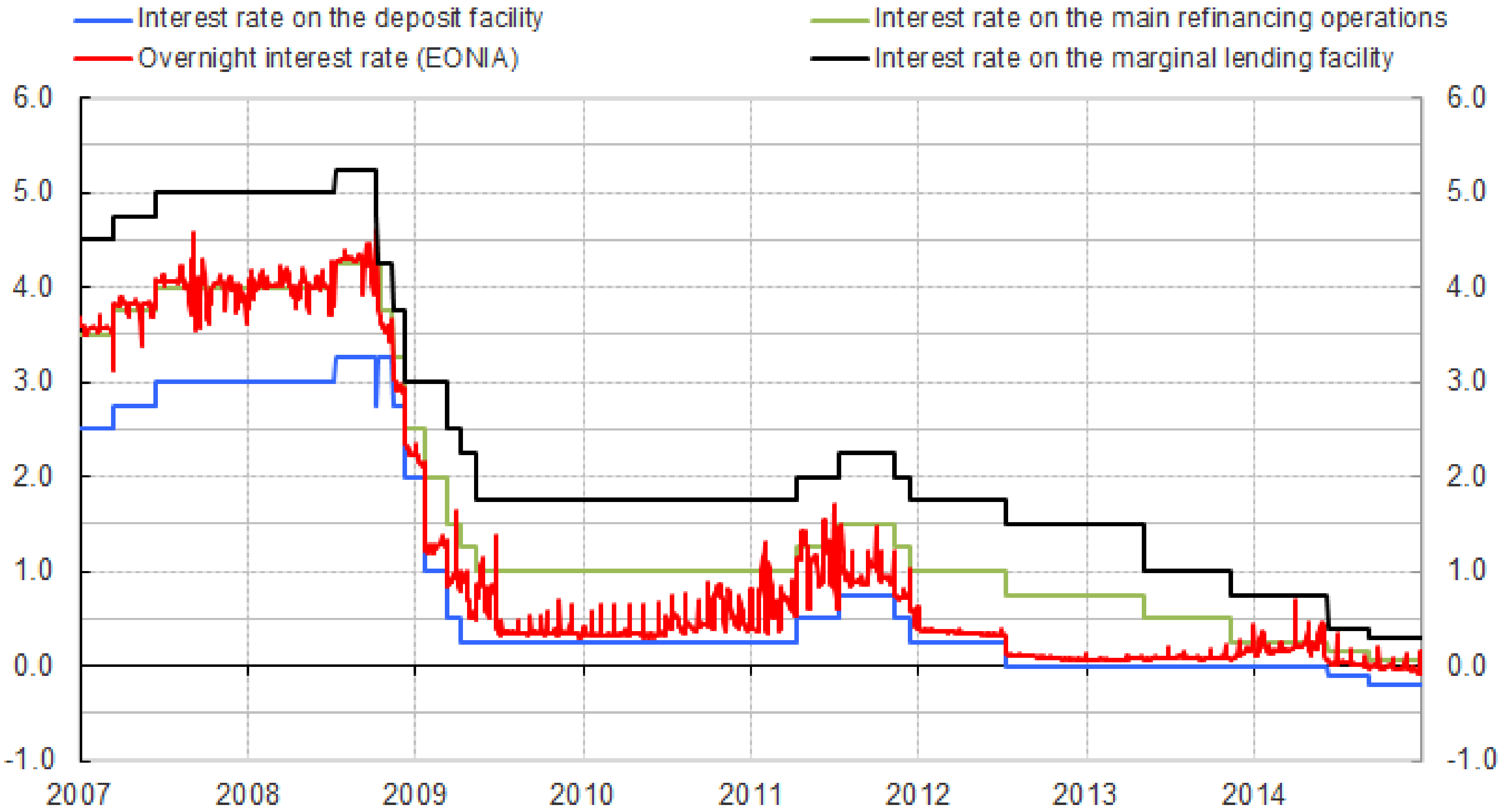
1 Overview of non-standard monetary policy measures

2 Channels of transmission

3 Global impact

ECB standard policy response: key ECB interest rates

(percentages per annum)



Latest observation: 31 `December 2014.

Overview of ECB non-standard monetary policy measures

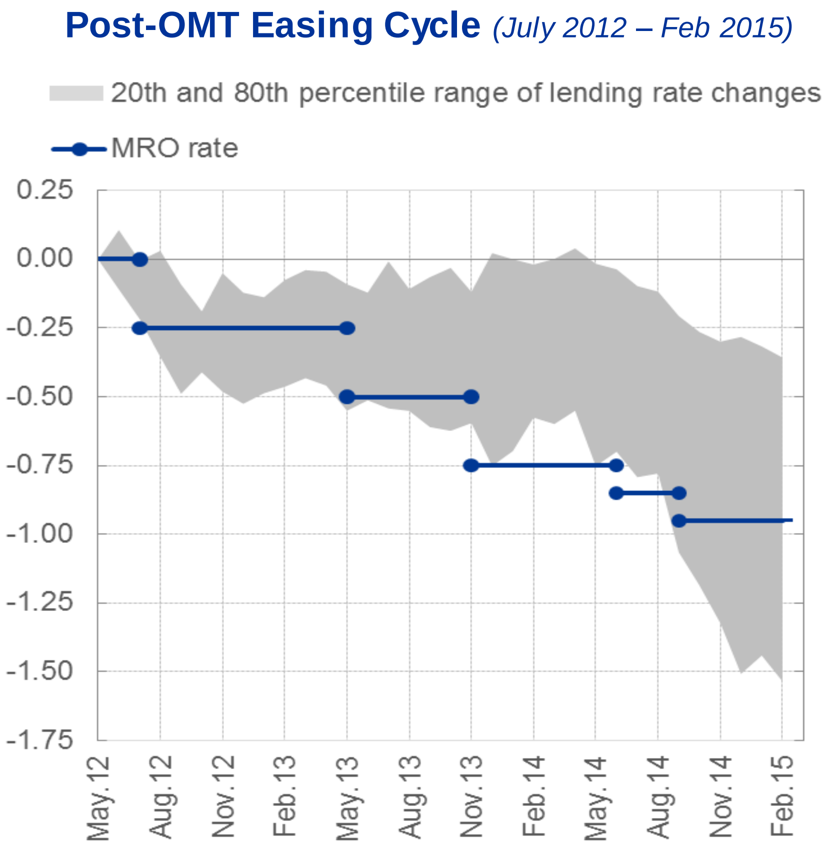
- Liquidity and funding measures
  - Fixed-rate tender procedure with full allotment
  - Extension of the maturity of refinancing operations (3y LTRO, November 2011)
  - Expansion of the collateral pool
- Outright purchases in malfunctioning market segments
  - Securities Market Programme (SMP)
  - Covered 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)

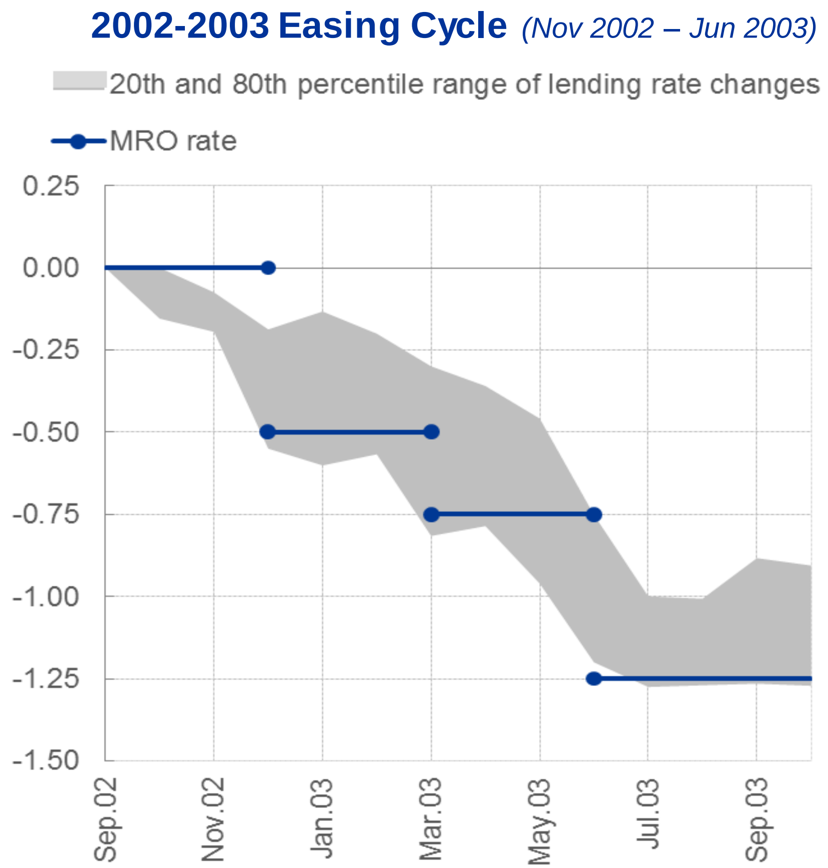
Impaired pass-through of policy rate cuts to the real economy

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

Transmission of MRO Rate Reductions to Bank Lending Rates

(percentages per annum)





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.

Forward guidance by the ECB (as from July 2013)

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.

Reaching the effective lower bound and credit easing

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

Objectives

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

An expanded Asset Purchase Porgramme (Jan/March 2015)

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

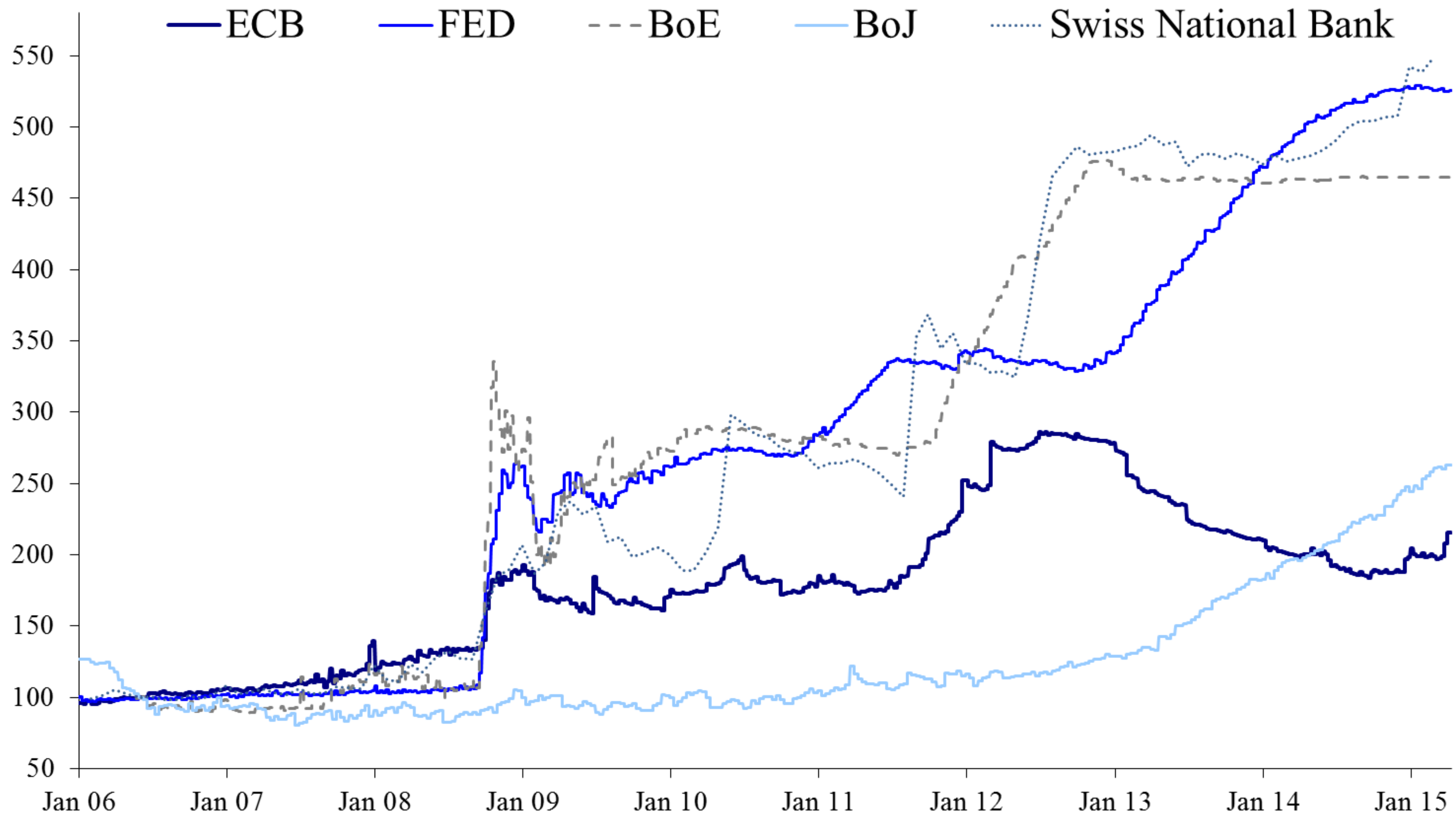
- Underpin a **firm anchoring of medium- to long-term inflation expectations**
- Contribute to a **sustained return of inflation towards a level below, but close to 2% over the medium-term**

Modalities of the expanded APP

- 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

Overview: expansion of central banks' balance sheets

Central banks' balance sheets - total assets
(Index 01 Jun 2006=100)



Outline

1 Overview of non-standard monetary policy measures

2 **Channels of transmission**

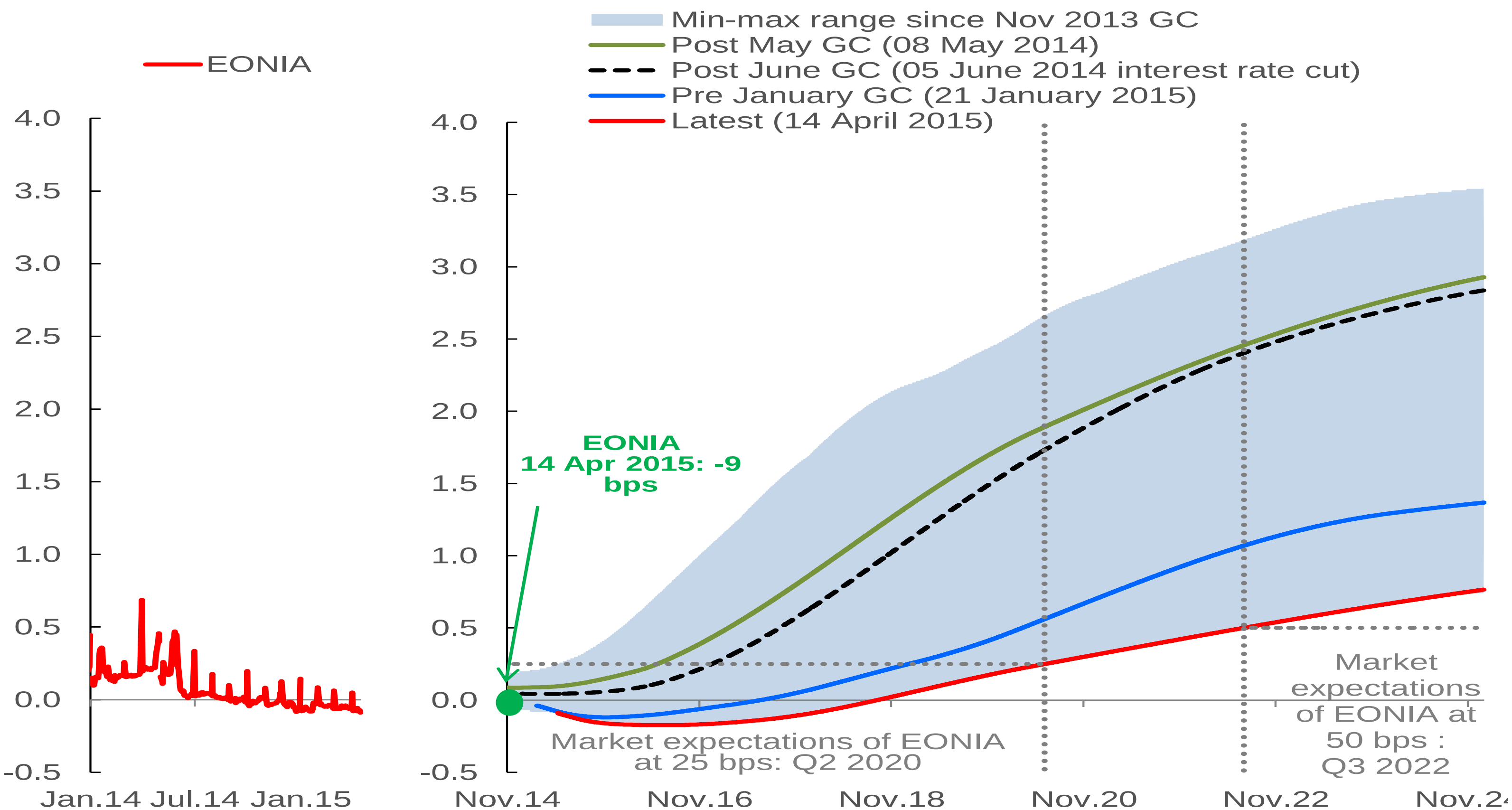
3 Global impact

Early APP findings: impact on interest rate expectations

Signalling channel: market expectations of future policy rates adjusted downward

EONIA forward rates

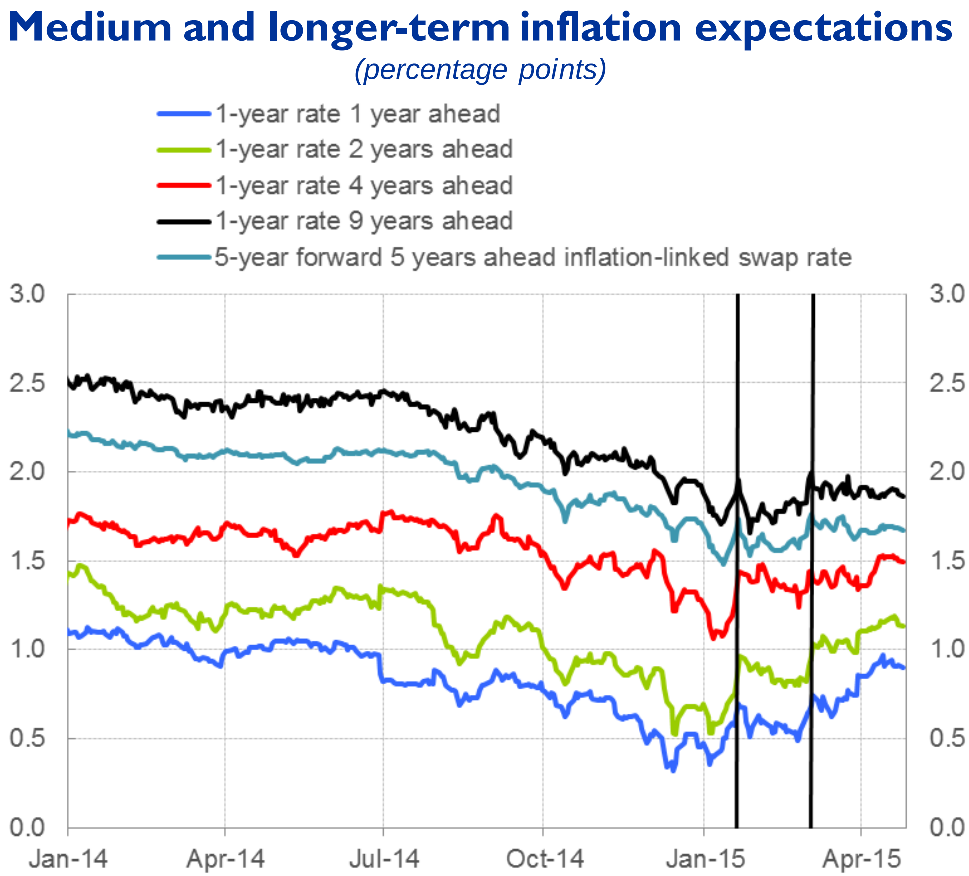
(based on EONIA swap rates; percentage per annum)



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

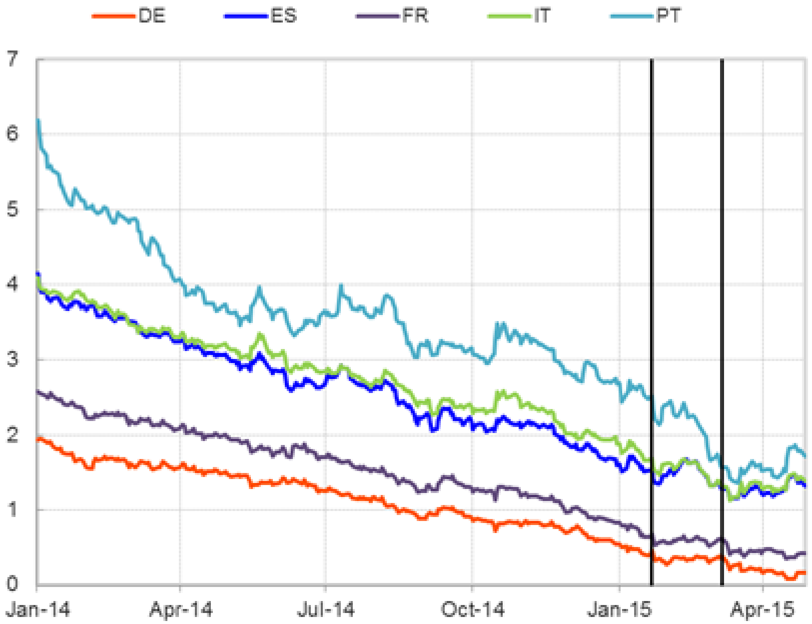


Source: Reuters data and ECB calculations.

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)

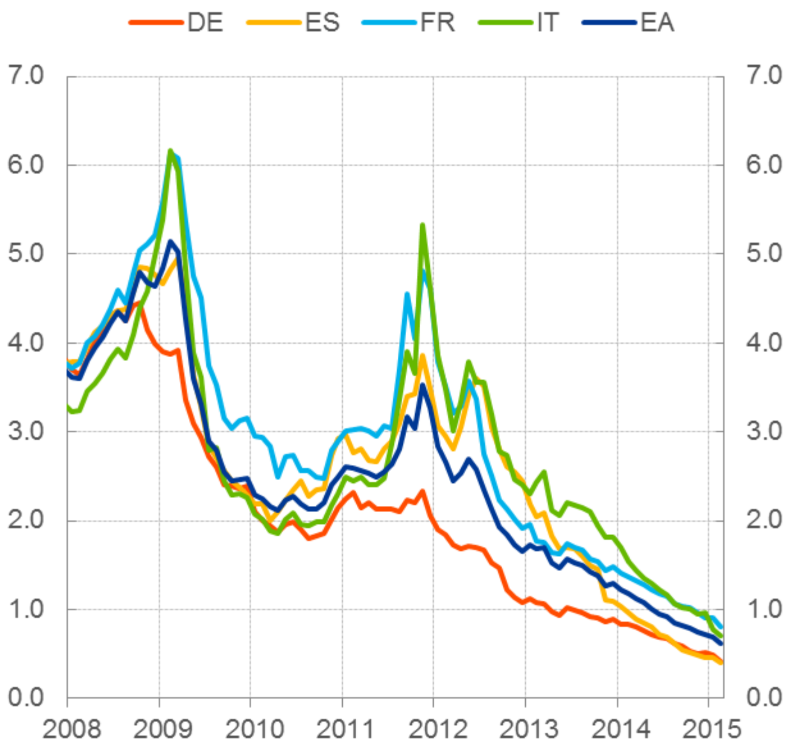
Source: Reuters.

Early APP findings: impact on bank credit conditions

Bank lending channel: lower bank funding costs and lending rates

Composite bank cost of debt financing

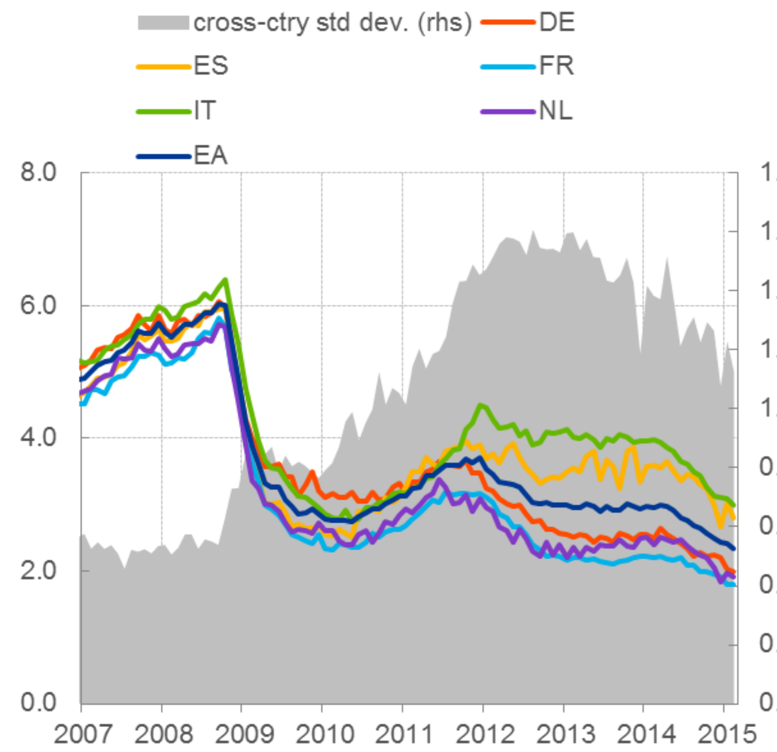
(percentages per annum)



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.

Total cost of lending to non-financial corporations

(percentages per annum; percentage points)

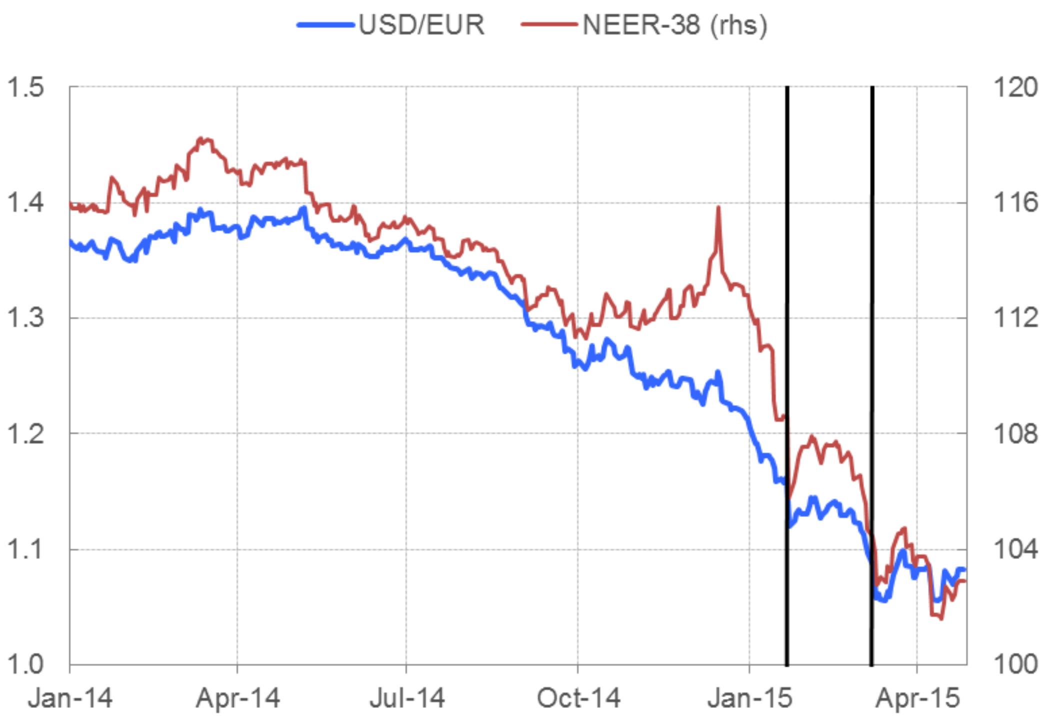


Source: ECB.
Notes: The indicator for the total cost of lending is calculated by aggregating short and long-term rates using a 24-month moving average of new business volumes. The cross-country standard deviation is calculated over a fixed sample of 12 euro area countries.
Latest observation: February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



Source: ECB.

Outline

1 Overview of non-standard monetary policy measures

2 Channels of transmission

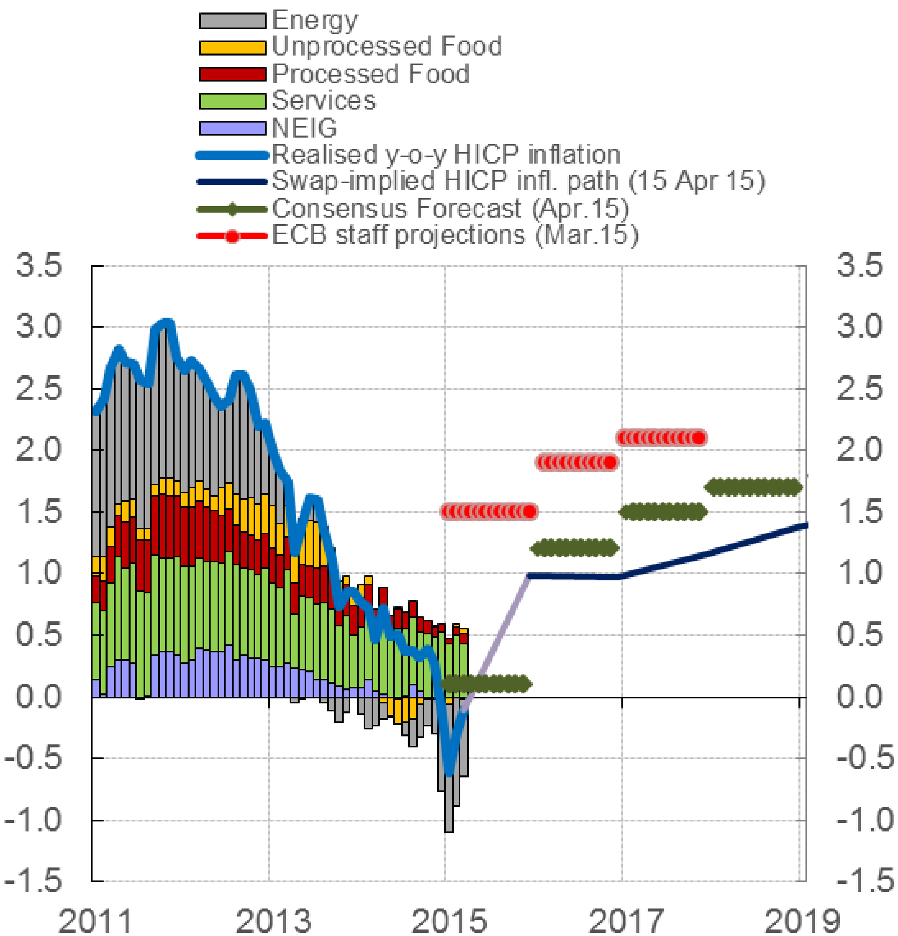
3 Overall impact

The recent inflation and macro landscape in the euro area

Moving in the right direction

Euro area HICP path

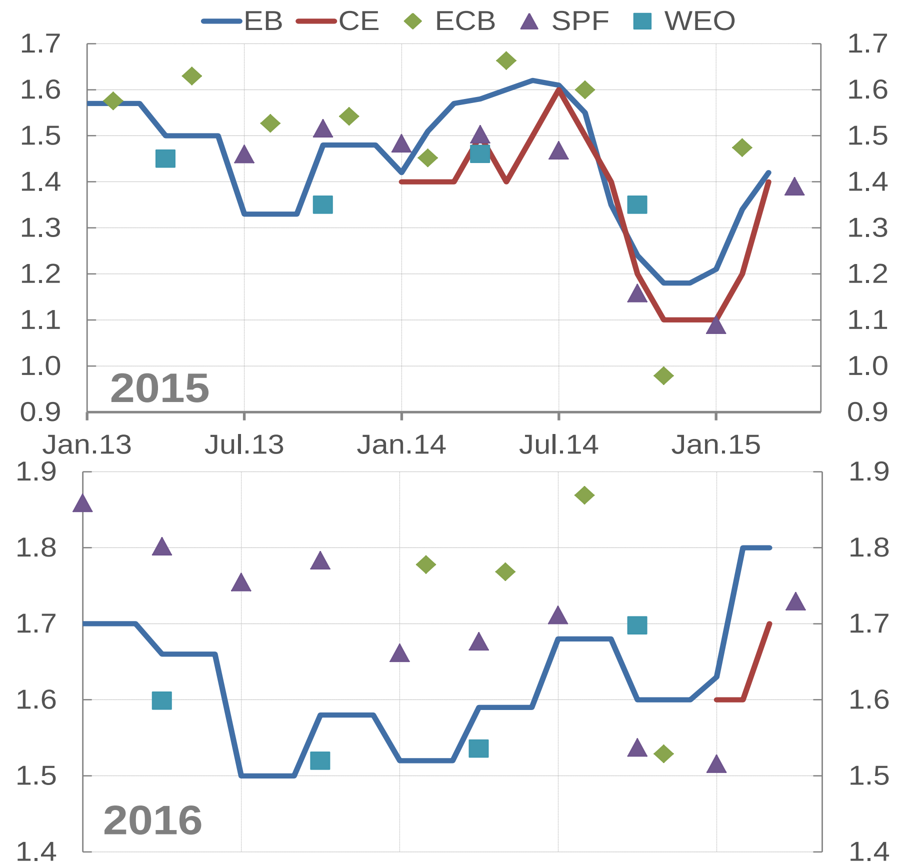
(percentages per annum)



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

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

(annual % growth)



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