

Erkki Liikanen, the Governor
Bank of Finland

Eurosystem's Monetary Policy and its Transmission

Rotman ICPM Forum
Old Student House, Helsinki
5 October 2015





Agenda

- I. Eurosystem's Expanded Asset Purchase Programme (EAPP): Background***
- II. Key features of EAPP***
- III. Impact of EAPP***

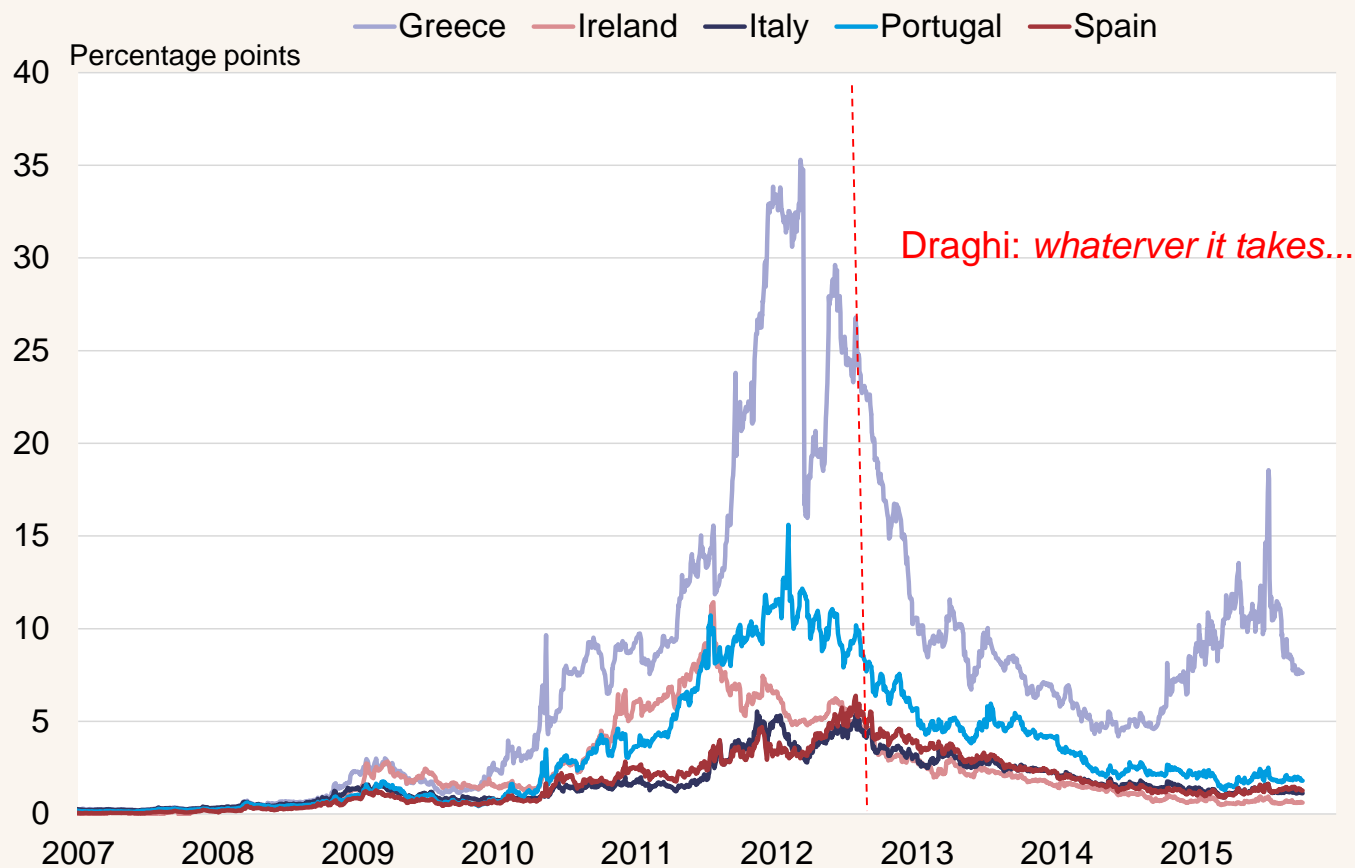


I. Eurosystem's Expanded Asset Purchase Programme (EAPP): Background



Decisive actions by the Eurosystem stabilised financial markets

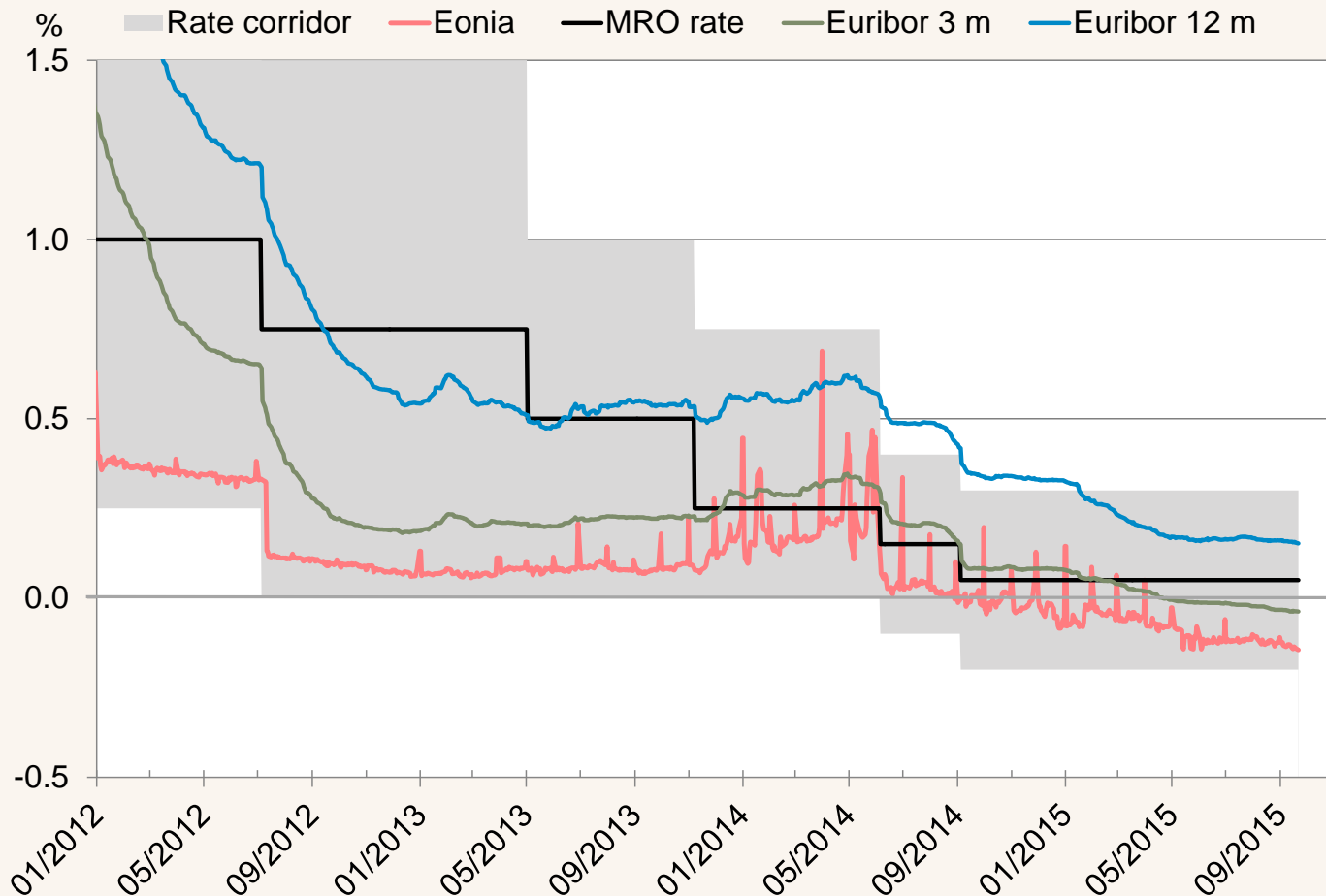
Spreads vs. the German 10-year government bond



Source: Bloomberg.



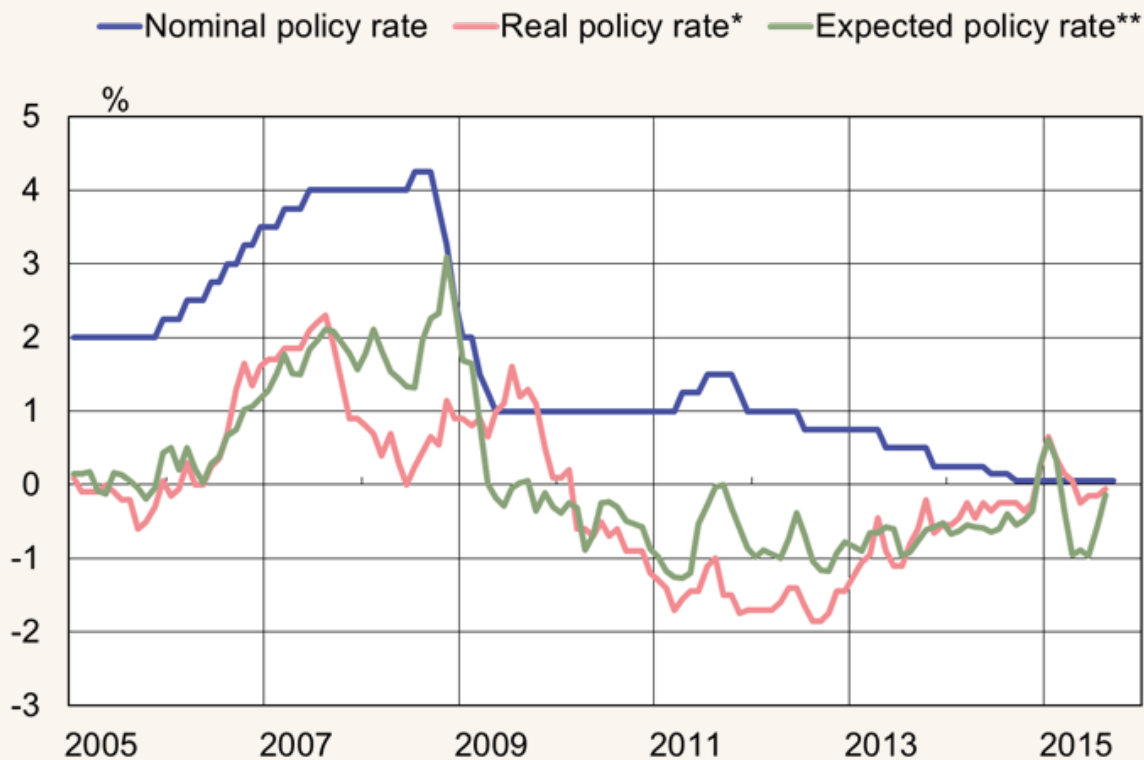
Traditional Monetary Policy restricted by zero lower bound



Source: European Banking Federation, Bank of Finland



Real interest rates increase when inflation expectations fall



Source: Eurostat, Bloomberg.

* Calculated using actual consumer prices.

** Calculated using one-year inflation swaps.

patu30199@rates



Eurosystem's accommodative monetary policy

- ***Central bank interest rates reduced to the zero lower bound.***
- ***Full allotment policy guarantees banks' access to central bank refinancing.***
 - *BoF has been active*
- ***Banks have access to longer-term central bank refinancing (maturing 2018) for provision of credit to the real economy (excl. housing).***
- ***Asset purchase programmes and forward guidance***



II. Key features of EAPP



The Eurosystem sets the liquidity of the euro area banking system

- ***Regular open market operations***
 - Driven by banks' demand
 - Steers short-term money market rates

- ***Outright purchases of assets***
 - Active steering by the Eurosystem
 - Steers long-term interest rates



EAPP consists of two parts

- ***Covered bonds***
 - ***Asset backed securities ABS***
- } Private sector purchase programme
CBPP3 + ABSPP
Purchases from primary and secondary markets
-
- ***Debt instruments issued by euro area governments and certain agencies, international or supranational institutions***
- } Public sector purchasing programme **PSPP**
Purchases from secondary market only



Key features of the programme

- ***60bn euros per month (PSPP, CBPP3, ABSPP)***
- ***Purchases continue until a sustained adjustment in the inflation path consistent with the price stability target.***
- ***ECB co-ordinates, national central banks execute***
- ***Securities lending facilities are in place***
- ***Purchases extend to very long maturities (30 years)***
- ***Securities are bought with newly issued central bank money, which effectively has a yield of -0,2% (i.e. the rate on the deposit facility)***



III. Impact of EAPP



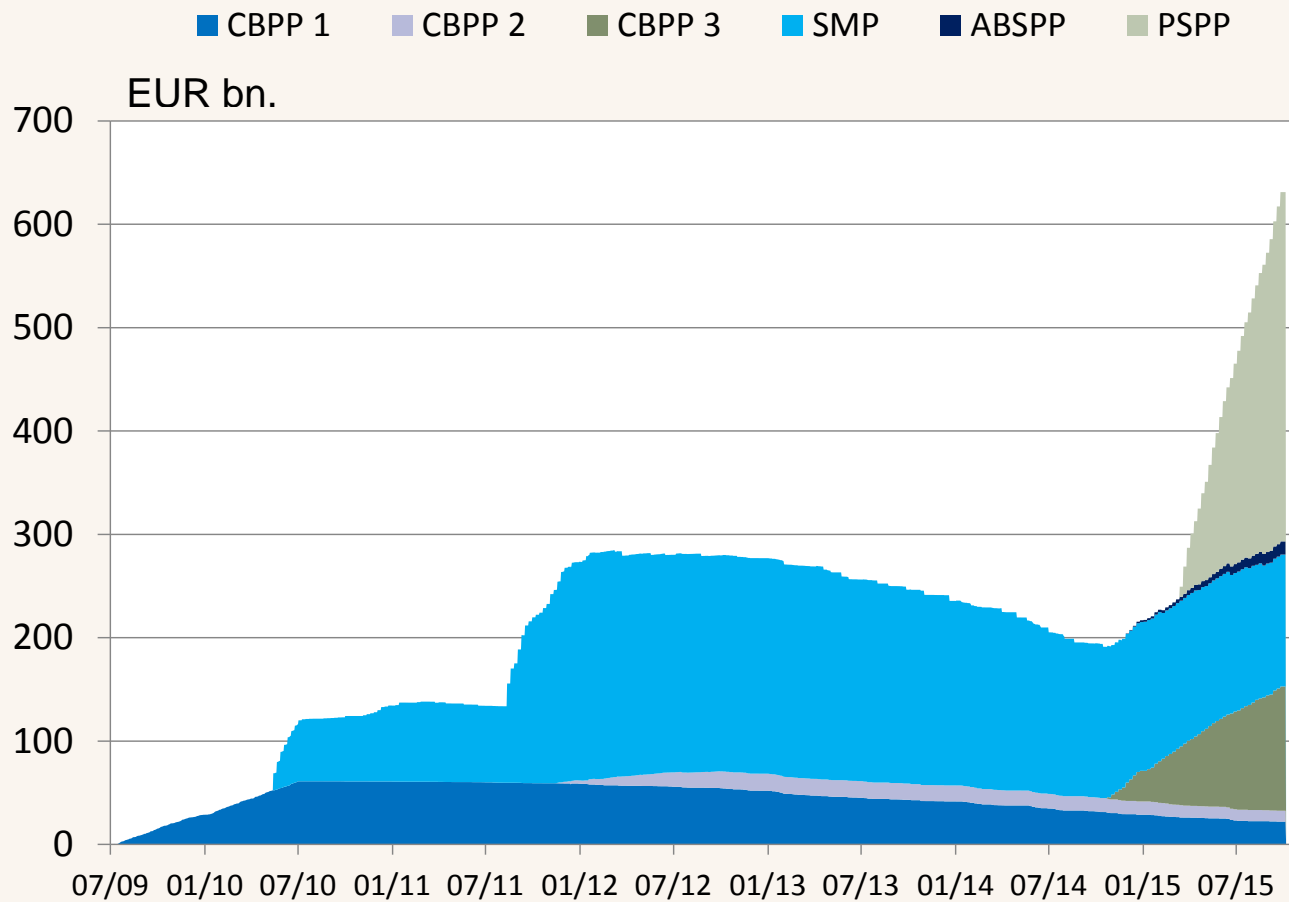
Transmission of central banks' asset purchase programmes

- ***Central Bank's balance sheet and banking system's liquidity increase; longer maturity of holdings***

- ***Transmission to economic growth and inflation via financial markets***
 - *Yield curves*
 - *Lending rates*
 - *Other asset prices*



Implementation has been smooth. "It is a marathon"



Source: Bloomberg.



EAPP affects inflation and output via several channels

1. *Expectations channel*

- Immediate market effects

2. *Signalling channel*

- Signalling of continuation of relaxed monetary policy

3. *Portfolio balance channel*

- Change in composition of investment portfolios

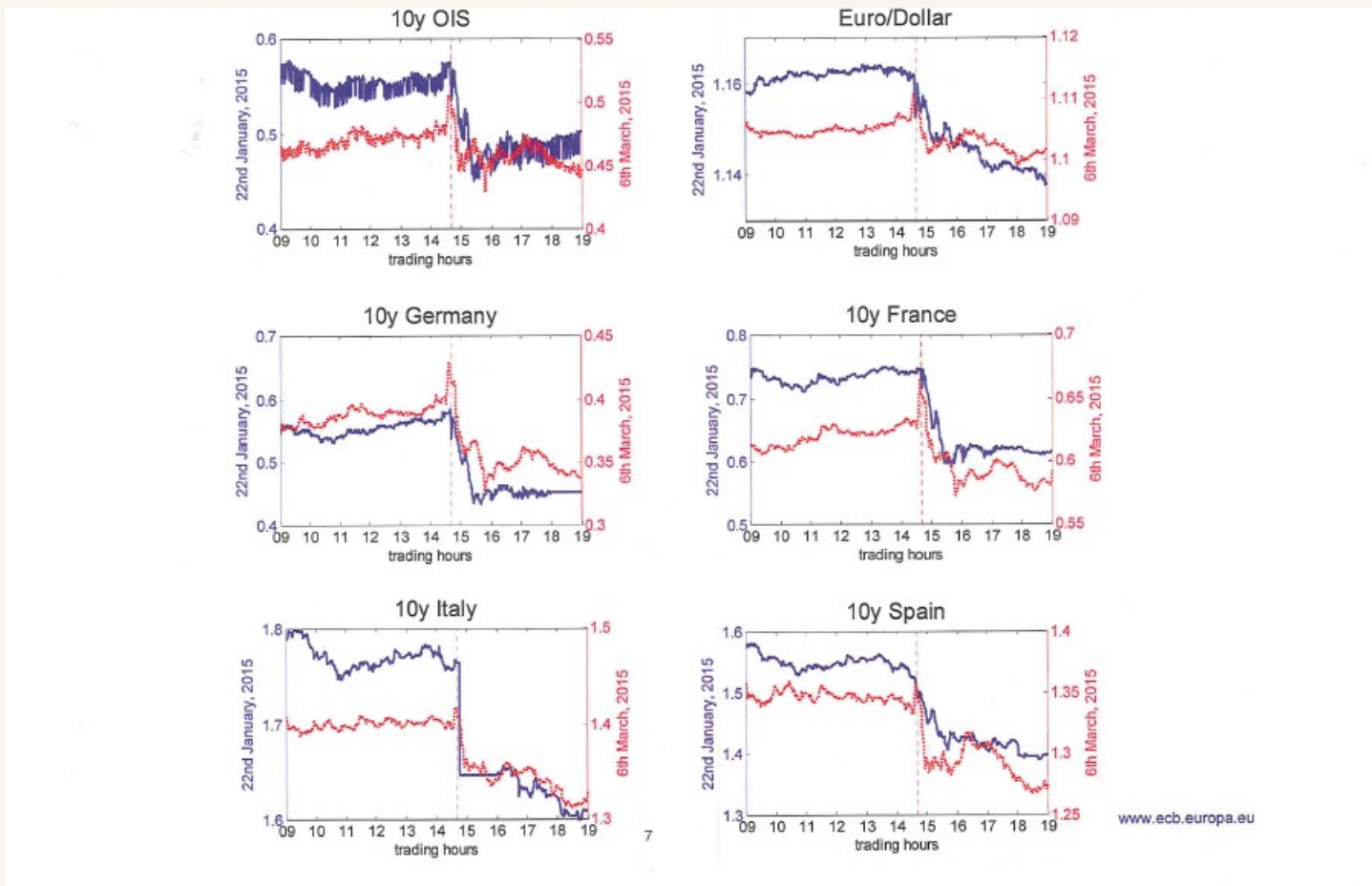
4. *Exchange rate channel*

- Capital flows outside euro area weaken the euro

→ ***Output increases, inflation rises***



1. Expectations: First impact, immediate intraday movements in asset prices on 22 Jan



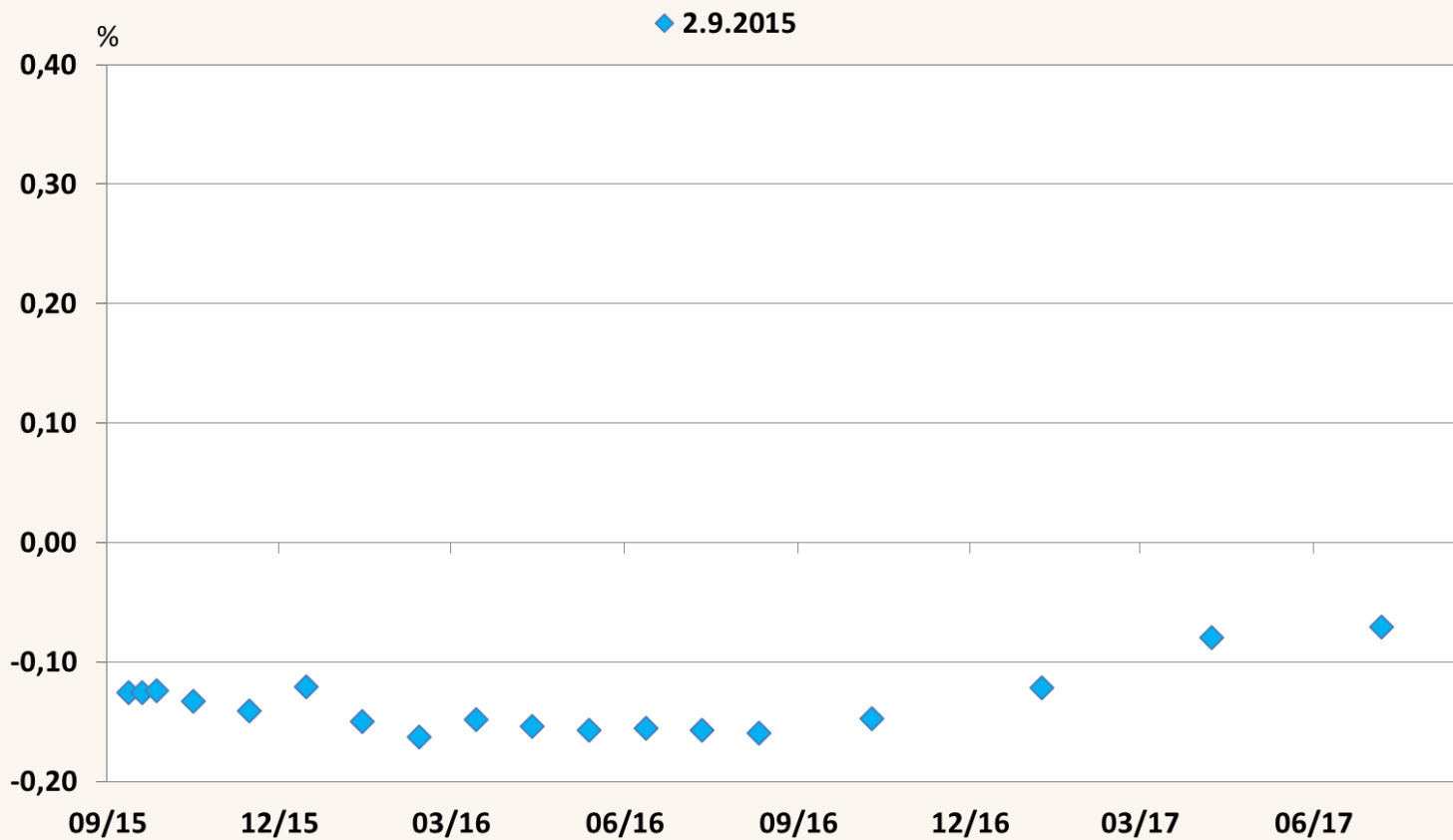


2. Signalling: Forward guidance is an intergal part of EAPP

- ***Governing Council (4.7.2013): interest rates to remain at present or lower levels for an extended period of time***
- ***The decision to launch the expanded asset purchase programme (EAPP) on 22.1.2015 strengthened forward guidance further:***
- ***[EAPP is] intended to be carried out until end-September 2016, or beyond, if necessary, and in any case, until we see a sustained adjustment in the path of inflation that is consistent with our aim of achieving inflation rates below, but close to, 2% over the medium term (Governing Council 3.9.2015)***
 - ***BoF has been active in developing forward guidance***



2. Signalling: Money market rates expected to remain low

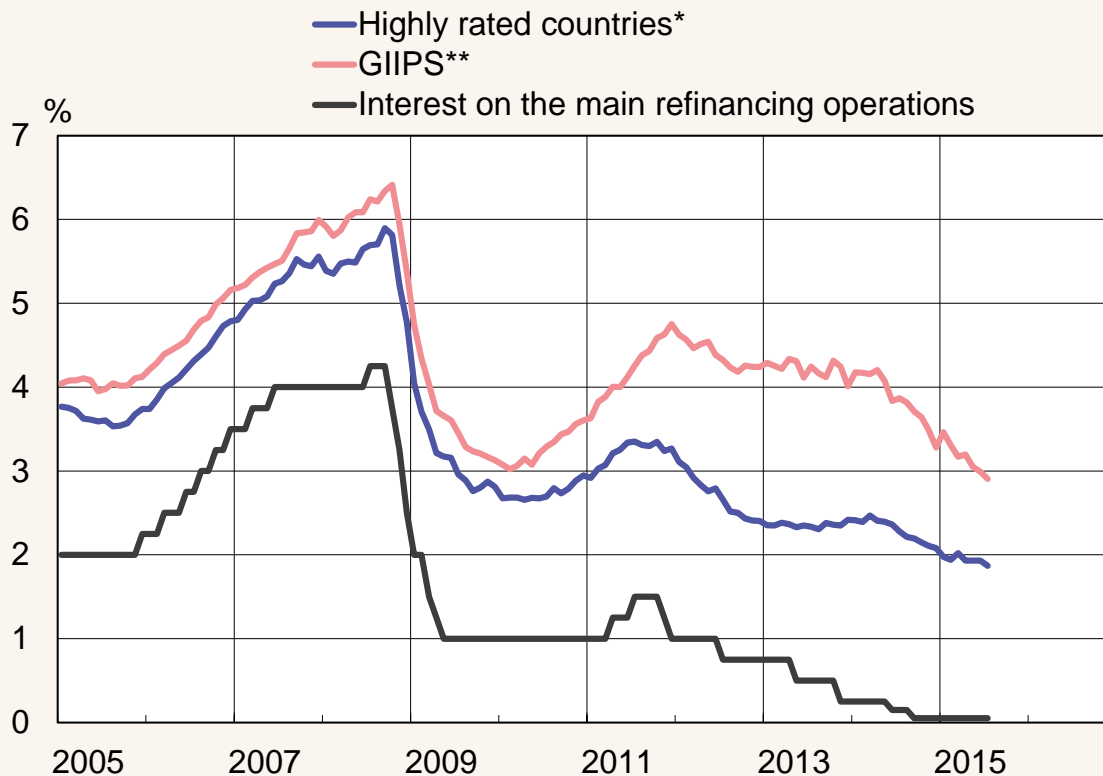


Lähde: Reuters, eonia expectations derived from eonia swaps



2. Signalling: Transmission of low policy rates to provision of credit has improved

New corporate loan agreements, average interest



Source: European Central Bank.

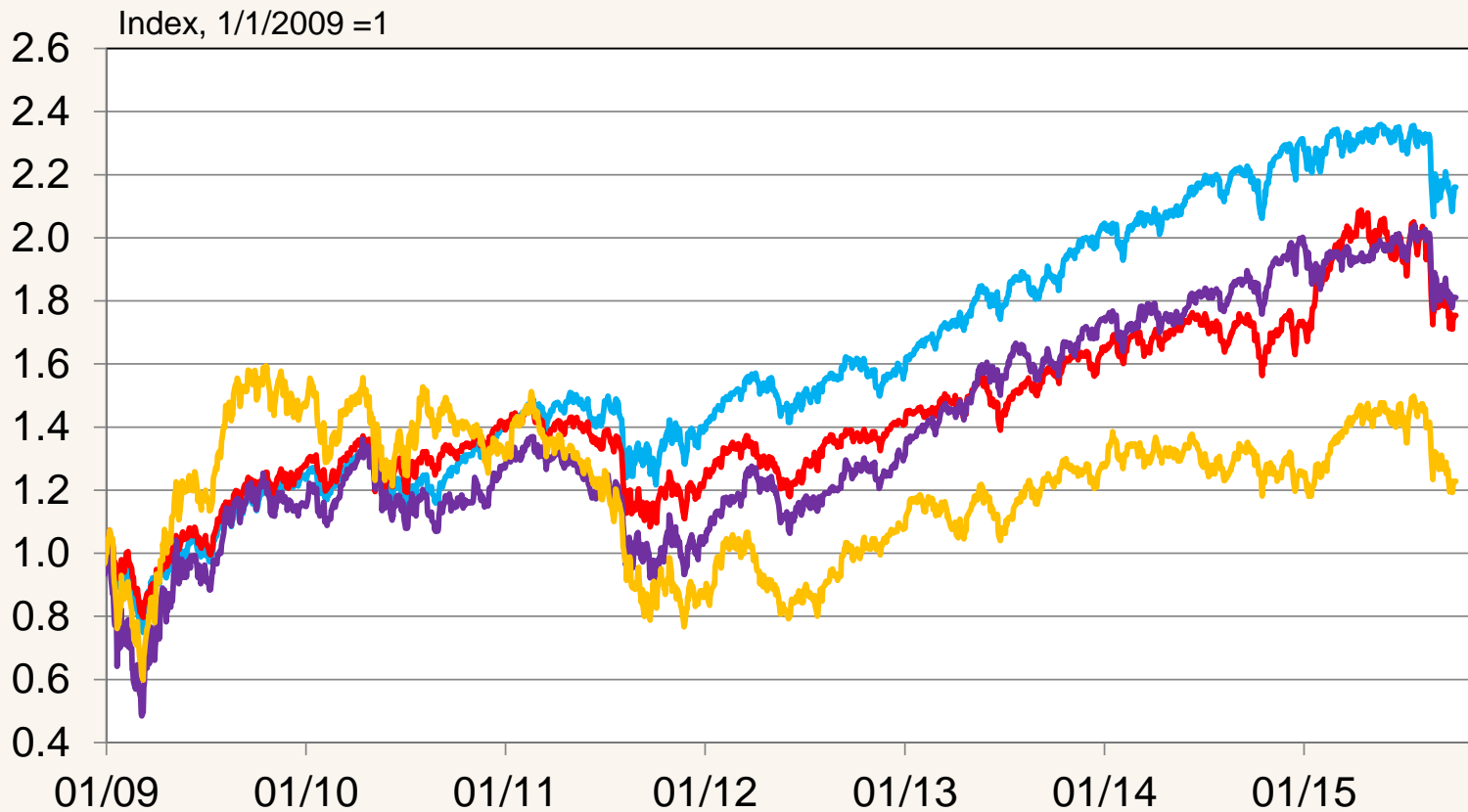
* Germany, France, Netherlands, Belgium, Austria and Finland.

** Greece, Ireland, Italy, Portugal and Spain.



3. Portfolio balance: Share prices have increased, recently increase in volatility

- S&P 500
- US financial sector
- STOXX Europe 600
- Europe financial sector



Source: Bloomberg



3. Portfolio balance: effects of EAPP on pension funds

- ***In the short run, the EAPP lowers bond yields***
 - Value of other asset classes, such as equity, increases.

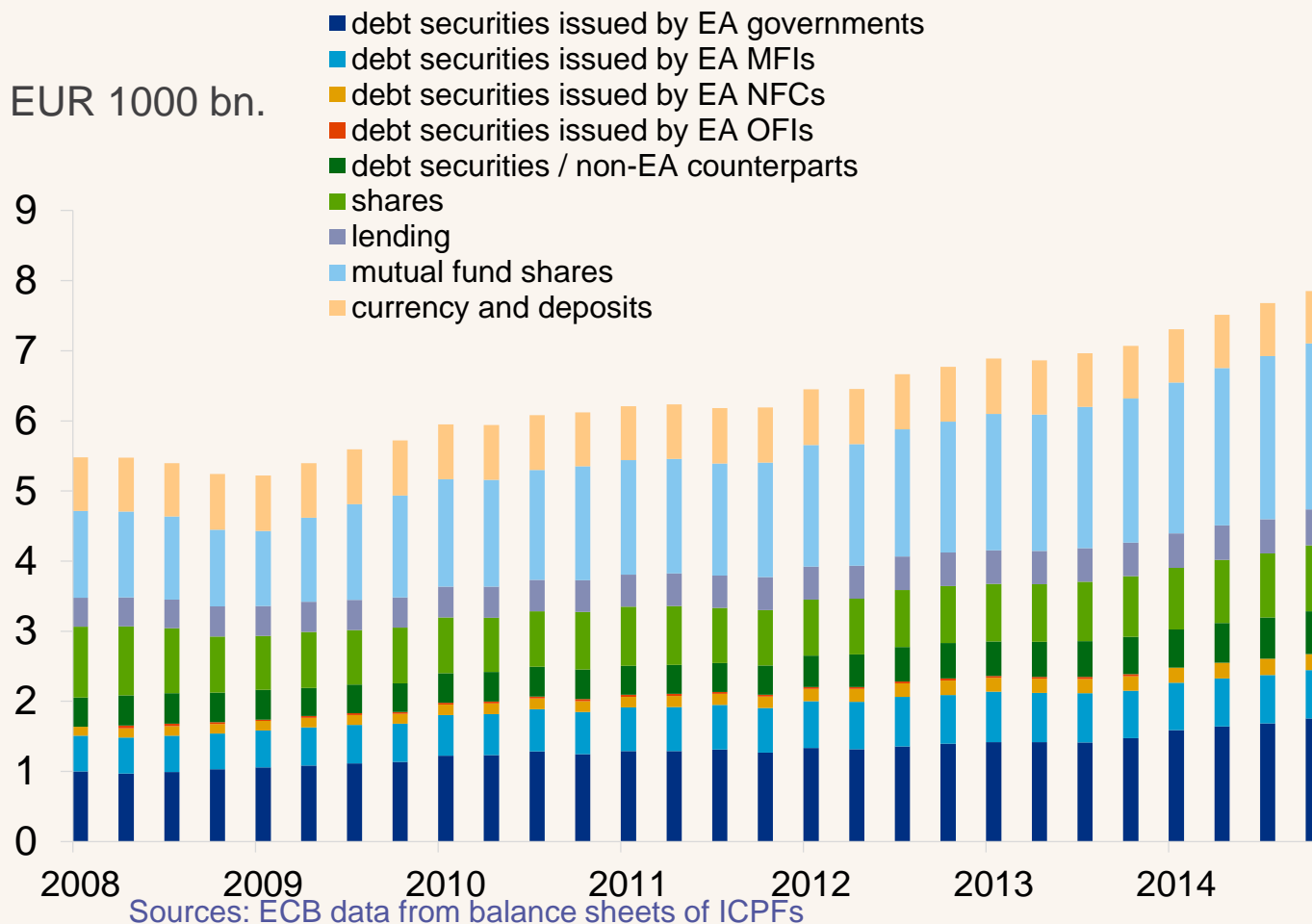
- ***Financial stability risks from the low interest rate environment may arise***
 1. Investors move to asset classes with high risk when searching for yield
 2. Defined benefit pension schemes may cause losses

- ***In the long run, price stability and sustainable economic growth form a crucial base for sound pension provision.***

- ***Financial sector risks cannot be eliminated by monetary policy; macro-prudential policies needed.***

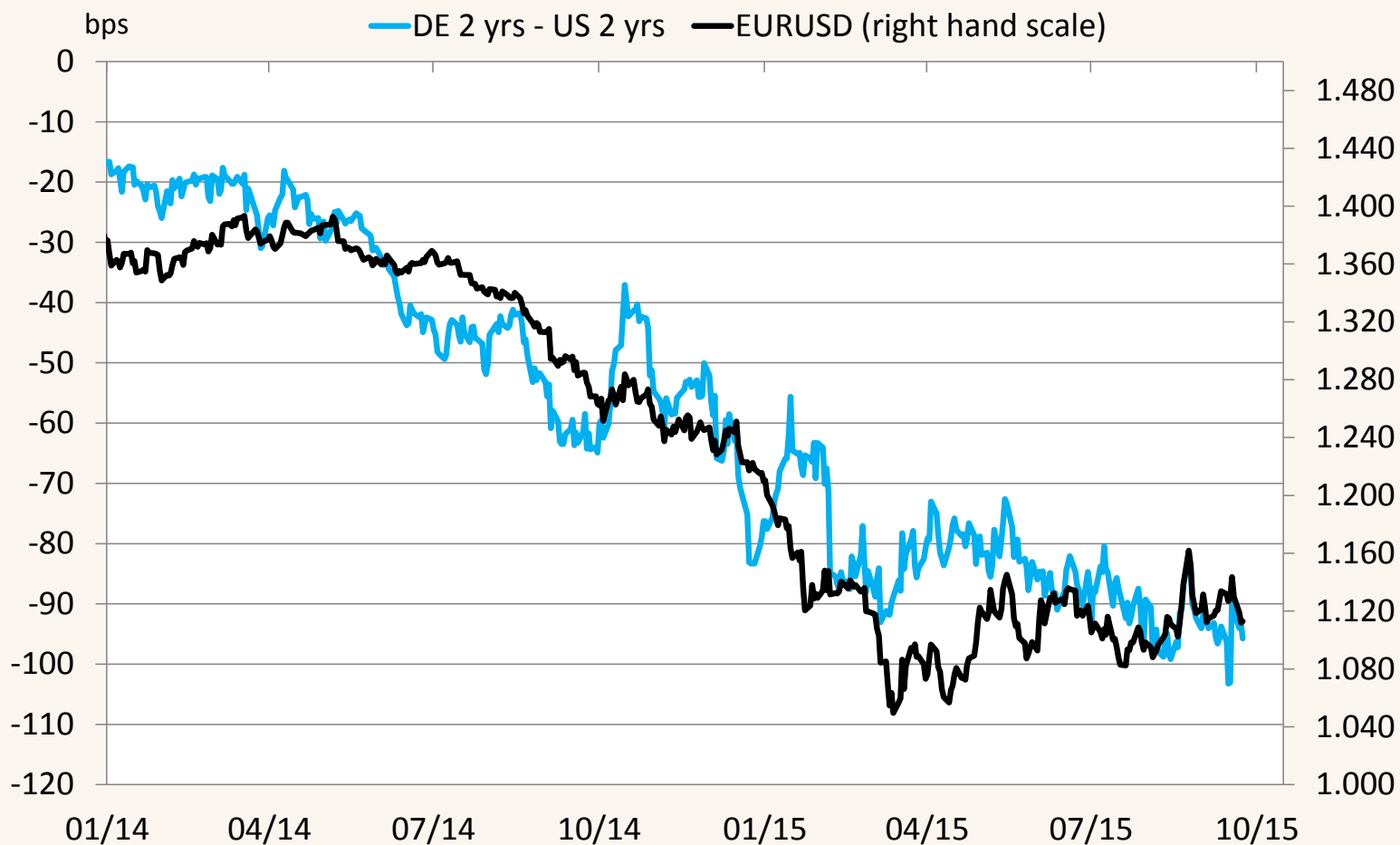


EA governments bonds make 24 % of insurance companies' and pension funds' assets





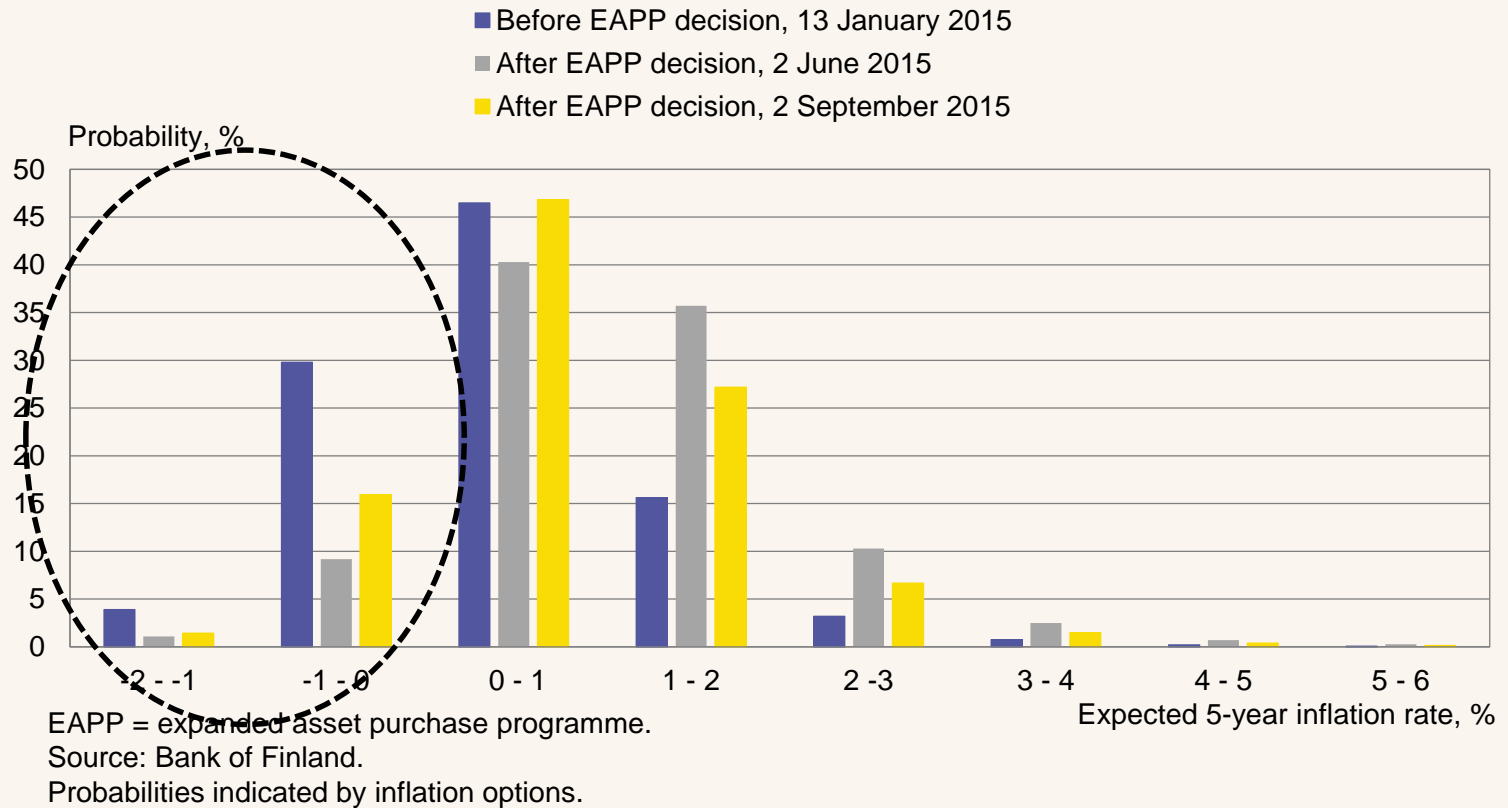
4. Exchange rate: The fall in EUR/USD since mid-2014 reflects policy divergence



Source: Bloomberg

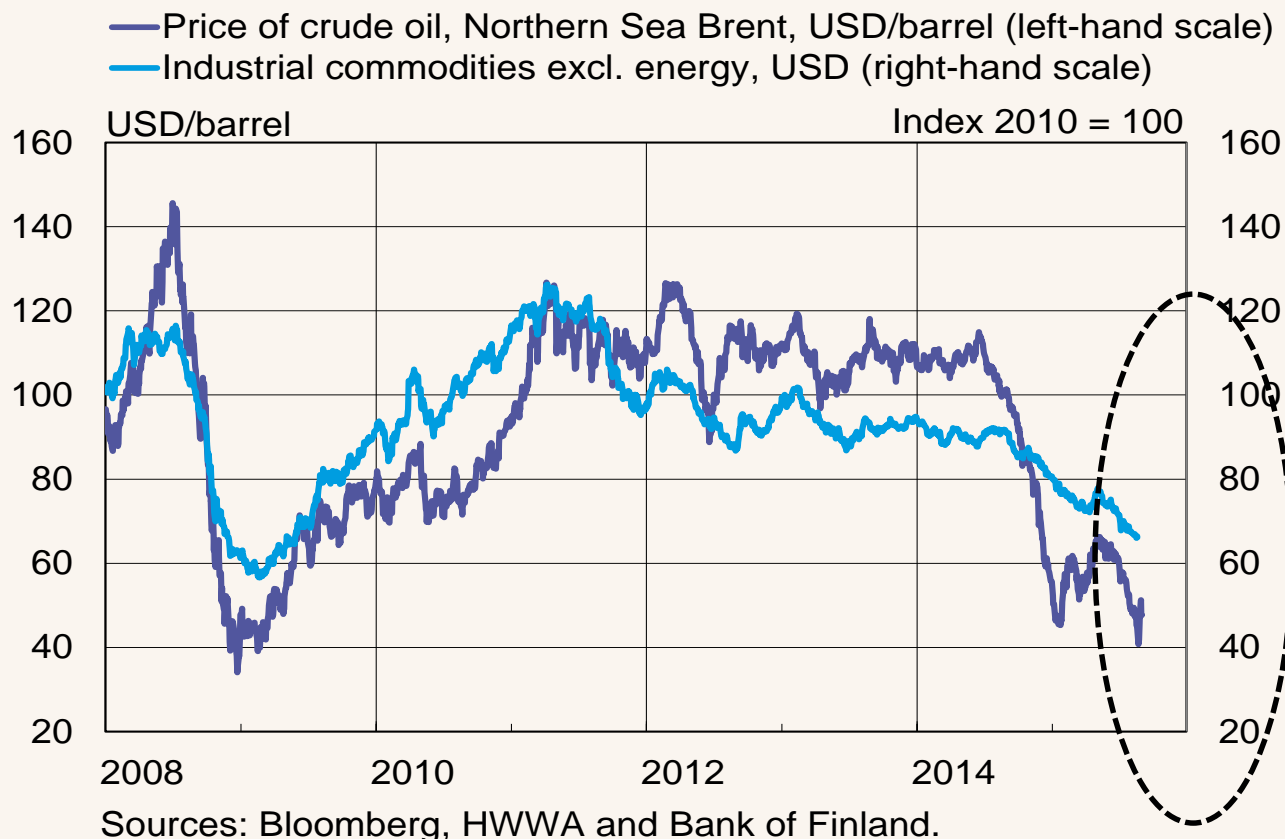


Probability of deflation has declined after EAPP decision in January





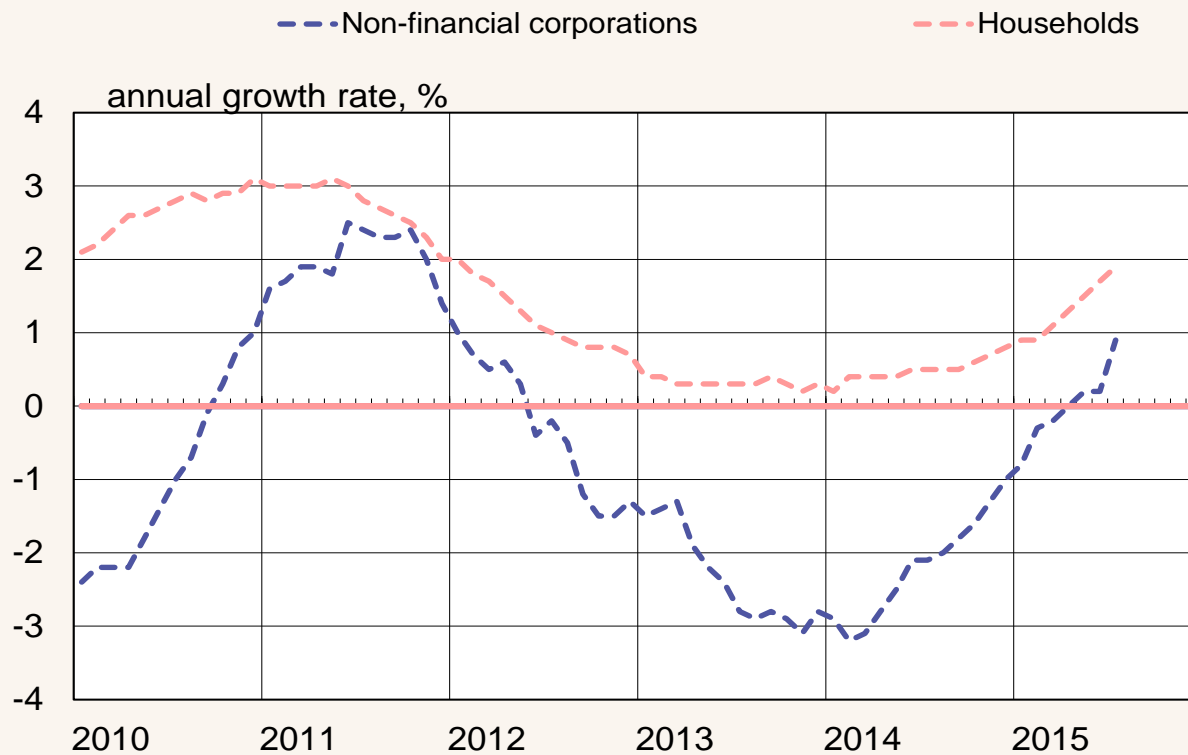
Renewed decline in oil prices has put downward pressure on prices





Lending volumes have improved

Loan growth in euro area



Source: European Central Bank
Loans adjusted for sales and securitisation



ECB staff projections in September

(difference to Eurosystem staff June 2015 projections)

- **GDP:**

2015: 1.4% (-0.1)

2016: 1.7% (-0.2)

2017: 1.8% (-0.2)

- **Inflation:**

2015: 0.1% (-0.2%)

2016: 1.1% (-0.4%)

2017: 1.7% (-0.1%)



Thank you!