Unconventional Monetary Policy Measures – Selected Issues

Session 6: Non-conventional monetary policy, macroprudential policies and their impact on liquidity of government debt

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Unconventional monetary policy measures – Comparison

<table>
<thead>
<tr>
<th>Unconventional Monetary Policy Measure</th>
<th>EUSY</th>
<th>FED</th>
<th>BOJ</th>
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<tbody>
<tr>
<td>1a Extended period of very low interest rates</td>
<td>X</td>
<td>X</td>
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<td>1b Forward guidance on interest rates</td>
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<td>2 Provision of longer-term liquidity</td>
<td>X</td>
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<td>3 Purchases of government securities</td>
<td>X</td>
<td>X</td>
<td>X</td>
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<td>4a Purchases of covered bonds</td>
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<td>4b Purchases of asset-backed securities (including MBS)</td>
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<td>4c Purchases of non-financial corporate debt</td>
<td>X</td>
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<tr>
<td>4d Purchases of other assets (agency debt, ETFs, REITs, CP etc.)</td>
<td>X</td>
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</table>

Henner Asche
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Selected unconventional monetary policy measures – ECB’s objectives

- General approach: appropriate measures depend on structure of credit markets
  - In the euro area, the role of banks is more important than in the US (about two thirds of financial intermediation via banking system, much less so in the US).

- Provision of longer-term liquidity; covered bond programs
  - Maintain sufficient bank intermediation and provide longer-term bank financing in times of stressed funding markets (prevent forced deleveraging, i.e. fire sales); sustain key bank funding channel.

- Government bond purchase program SMP
  - Address malfunctioning of securities markets and safeguard appropriate monetary policy transmission mechanism.

- Government bond purchase program OMT
  - Safeguard appropriate monetary policy transmission and singleness of monetary policy; elimination of “redenomination risk”, the unwarranted perception of a risk of euro breakup.
Unconventional monetary policy measures – Selected risks

- **Impact of sustained low interest rates**
  - Banks have incentives to delay balance sheet restructuring
  - Reduced pressure on authorities to implement rigorous bank restructuring
  - Market functioning distortions (in particular allocation function)

- **Impact of asset purchases, provision of longer-term liquidity**
  - Large increase of bank liquidity could cause banks’ addiction to central bank funding
  - Bank balance sheet restructuring and restoration of interbank market delayed
  - Shift of credit risk away from private sector into books of central banks and finally the tax payer
  - Market functioning distortions, drying-up of markets, lack of good-quality collateral

- **Exit risks**
  - Increased credit risk for banks (impact of higher interest on NPL), losses on “available for sale” fixed rate securities due to rising interest rates
  - Bank funding challenges, reduction of excess liquidity particularly exposes most vulnerable banks
  - Underlying structural issues must be addressed by market participants
Unconventional monetary policy measures – Liquidity in euro area government bond markets (1/2)

**Spain - Bid-Ask Spread***

10-Year Government Bonds; Source: Bloomberg.

- SMP1 (off.)
- SMP2 (off.)
- OMT (Draghi, London)

**Portugal - Bid-Ask Spread***

10-Year Government Bonds; Source: Bloomberg.

- SMP1 (off.)
- SMP2 (off.)
- OMT (Draghi, London)

**Italy - Bid-Ask Spread***

10-Year Government Bonds; Source: Bloomberg.

- SMP1 (off.)
- SMP2 (off.)
- OMT (Draghi, London)
Unconventional monetary policy measures – Liquidity in euro area government bond markets (2/2)
Final remarks …

It is not the task of the ECB to rescue the whole system. Governments have agreed on a mechanism to grant loans, of course subject to strict conditionality, in cooperation with the IMF (…)

Lorenzo Bini-Smaghi, Member of the Executive Board of the ECB, Interview with Börsen-Zeitung, published on 20 May 2010.