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Overview of and recent changes in the monetary policy implementation framework

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The views expressed in this presentation do not necessarily reflect those of the ECB/Eurosystem

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Overview of the presentation

1	Eurosystem monetary policy implementation – an overview
2	Standard monetary policy tools and implementation
3	Non-standard monetary policy tools
4	A short comparison between then and now
5	The impact of ECB monetary policy on the Eurosystem balance sheet

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1. Eurosystem monetary policy implementation – an overview

Monetary policy implementation frameworks

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« Monetary policy operational frameworks concern the intermediate targets of central banks and how they meet them. This is distinct from monetary policy strategies, which concern the quantitative definition of policy objectives, the horizon over which they should be delivered as well as the organization and weighting of incoming information."

B. Coeuré (remarks at the 2016 Jackson Hole Symposium)

"Central bank financial market operations have been the central banks' portal to reality ever since the creation of central banks in the 17th century. (…) If operational frameworks are poorly designed, not only the achievement of a central bank's monetary policy objectives is put at risk, but in addition the efficiency and stability of the financial system can be undermined."

U. Bindseil, 2016 ("Evaluating monetary policy operational frameworks")

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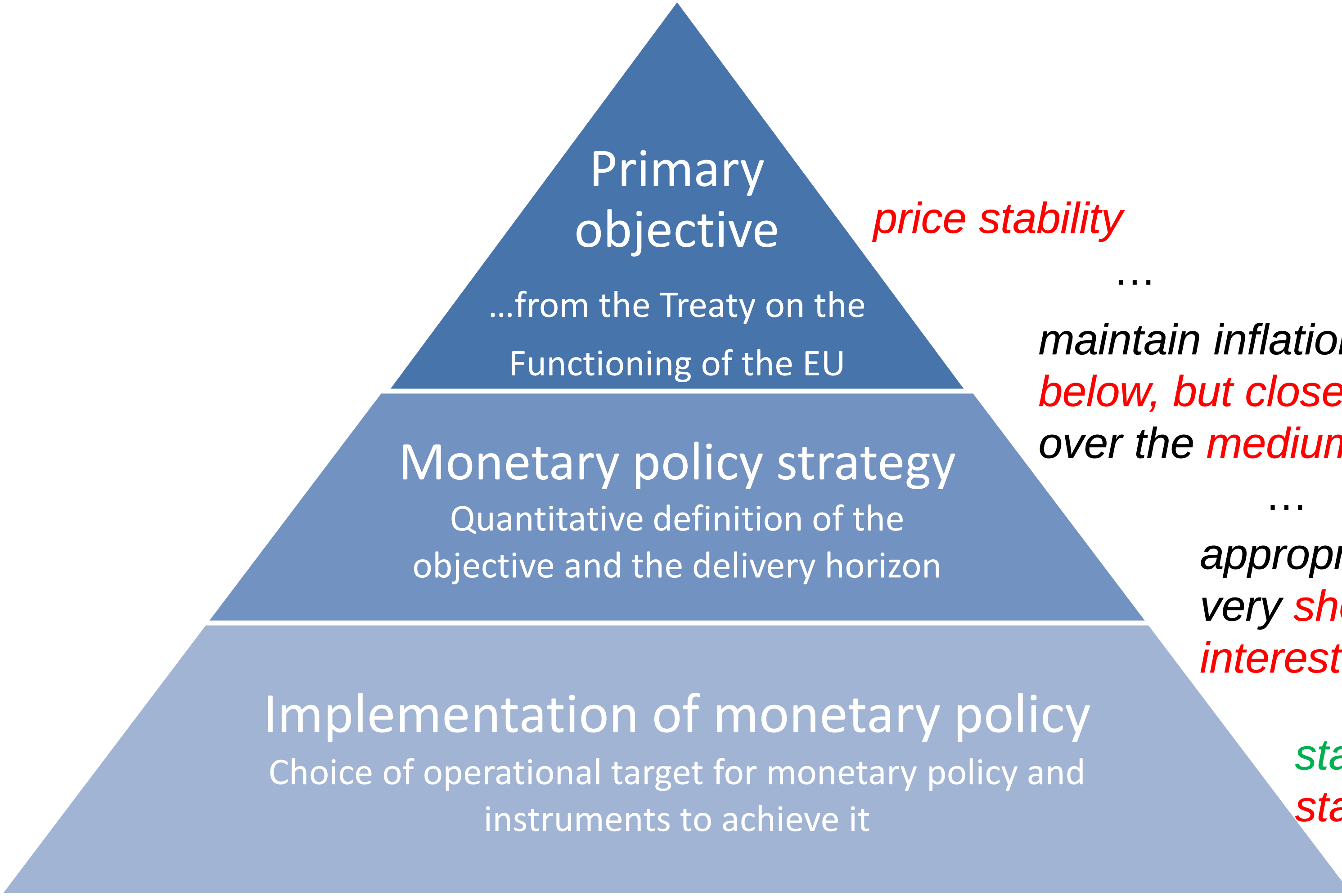
Monetary policy implementation (MPI) concerns the operational target of the Eurosystem and how it is met



price stability

…

maintain inflation rate below, but close to, 2% over the medium term

…

appropriate level of very short-term interest rates

…

standard and non-standard tools

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Joint decision making within the Eurosystem

ECB Governing Council

Delegation

ECB

NCBs

Decentralised implementation

Euro area banks

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2. Standard monetary policy tools and implementation

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Design of MPI toolbox reflects fundamental factors…

- **Factors affecting Eurosystem monetary policy**

Defining characteristic:		Implication for policy:
Economy in euro area mainly financed through banks	→	Focuses on banks
Diverse national banking systems	→	Ensures equal treatment/level playing field
Open economy with free allocation of resources	→	Consistent with the principle; e.g. floating exchange rate, price discovery

- **Eurosystem thus decided to work with**
  - liquidity deficit, enlarged by reserve requirements
  - secured monetary policy credit operations, conducted as tenders
  - two standing facilities (lending and depositing), creating a corridor
  - a broad range of counterparties
  - a broad set of assets as collateral

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Managing day-to-day liquidity to steer interest rates (1)

Monetary policy tools

1. Minimum reserve requirement

Reserve requirement

2. Open market *credit* operations

Main refinancing operation, MRO (1w)

Long-term refinancing operations, LTRO (3m)

Fine tuning operations (o/n-1w)

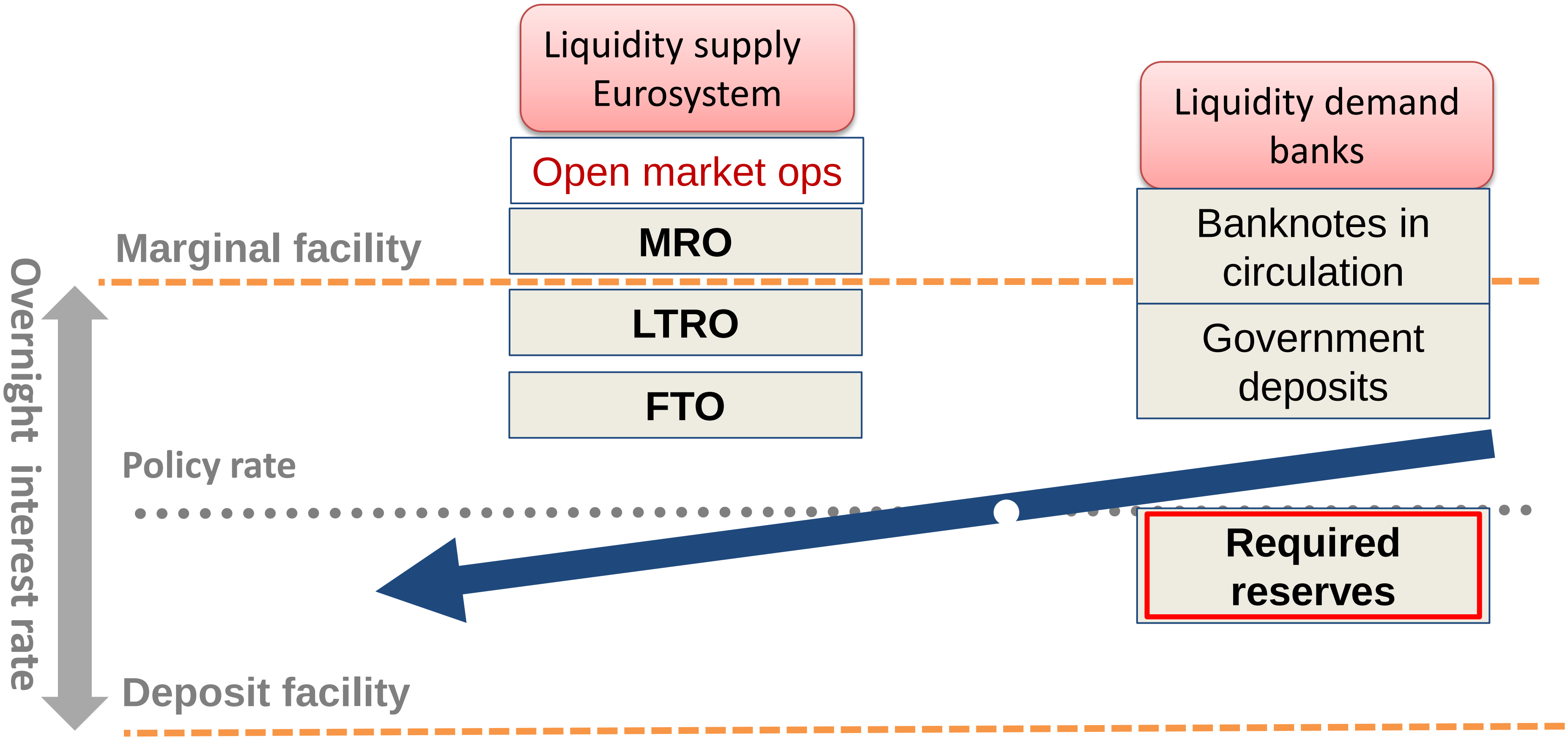
Standard instruments

3. Standing facilities

Marginal lending

Deposit

Managing day-to-day liquidity to steer interest rates (2)



Open market operations – how it used to be…..

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Main refinancing operations (MROs) - key for rate management

- MRO-amount set so that banks can fulfil their minimum reserve requirement and to accommodate expected (usually very small) demand for excess reserves. When money market works:
  - banks on aggregate need only this amount;
  - if more provided, some banks would have to deposit at an unfavorable rate;
  - if less provided, some banks would have to borrow at an unfavorable rate.
- For setting the MRO-amount, forecasting of autonomous factors needed.
- Bidding in MRO starting at the key policy rate (minimum bid rate) → short-term money market interest rate steered towards the key policy rate.

Long-term refinancing operations (LTROs)

- conducted monthly with 3-month maturity;
- fixed amount, variable rate.

A broad range of banks can participate in operations

- Decentralised implementation;
- Right to participate in monetary policy operations;
- Counterparty must fulfill the following criteria;
    1. Subject to minimum reserve requirement i.e. a credit institution (based in euro-area; subsidiary or branch)
    2. Under harmonized EU/EEA-supervision or comparable third country regime
    3. Financially sound, and
    4. Fulfilling operational criteria.
- Possibility for Eurosystem to take measures on a counterparty;
- Equal treatment of counterparties;
- Broader set for purchase programmes.

Many changes have taken place in recent years, with respect to (all of) its main building blocks, i.e. ……

- Counterparty framework,
- Collateral framework,
- Open market (credit) operations,
- Asset purchases,
- Standing facilities,
- Minimum reserve requirements.

….with impacts on Eurosystem's balance sheet, liquidity conditions and broader market conditions.

- As a result of these changes, the Eurosystem MPI framework is quite different compared with pre-crisis, and currently contains non-standard measures, as well as permanent and temporary elements.
- Hence, the MPI framework can be constantly challenged through changes in financial markets and the broader economic environment, including institutional or regulatory changes.

3. Non-Standard monetary policy tools

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Managing day-to-day liquidity to steer interest rates

Monetary policy tools

Standard instruments

1. Minimum reserve requirement

- Reserve requirement

2. Open market *credit* operations

- Main refinancing operation, MRO (1w)
- Long-term refinancing operations, LTRO (3m)
- Fine tuning operations (o/n-1w)

3. Standing facilities

- Marginal lending
- Deposit

Non-standard measures

- Extra lending operations (VLTRO, TLTROs; EUR, USD, CHF)

4. *Outright* asset purchases

- OMT
- CBPP1-3
- SMP
- CSPP
- ABSPP
- PSPP

Dysfunctional markets (mid 2007 – early 2010)

2008

- fixed rate full allotment policy in all refinancing operations
- prolongation of average maturity of refinancing
- expansion of collateral framework

2009

- Covered bond purchase programme (CBPP) of € 60 bn
- 3 FRFA 12-months LTROs

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Sovereign debt crisis (mid 2010 to mid 2014)

2010

- Securities Market Programme (SMP): *"non-standard measure to temporarily intervene in euro area debt securities markets **to ensure depth and liquidity in dysfunctional market segments** and to restore an appropriate monetary policy transmission mechanism"*
- *Liquidity effect was sterilized*

2011

- CBPP2 of up to € 40 bn to support banks' funding position
- Two FRFA 3-year LTROs
- Reserve ratio reduction from 2 to 1%

2012

- "Whatever it takes": Outright monetary transactions (OMTs)

2013

- Introduction of forward guidance

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Additional and maintained accommodative monetary policy (mid 2014 until now)

2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019

Non-standard measures	When?
Negative deposit rate	Jun 2014
Strengthening forward guidance	Jun 2014
Extending FRFA policy	Jun 2014
TLTROs	Sep 2014
CBPP3 and ABSPP/APP	Oct 2014
PSPP/APP	Mar 2015
CSPP/APP	Apr 2016
TLTRO II	June 2016
APP reinvestment phase	Jan 2019
TLTRO III	Sep 2019

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Credit operations during the crisis: Fixed rate full allotment and longer maturities – as much money as you want (against collateral) for longer!

- **FRFA** is one of the most important innovations in particular during the early stages of the crisis:
  - **Banks can get their full bid amount at fixed rate** (key policy rate) against collateral;
  - In place since October 2008 and at least until March 2021;
  - Element of forward guidance.
- **Longer maturity credit operations introduced** (up to 3 year maturity and 4 year maturity with TLTROs);
- FRFA applied also to longer operations (except TLTROs);
- USD and CHF lending operations;
- **Nota bene**: Excess borrowing is a cost to the banking system so only used to the extent necessary – **automatic exit.**

TLTRO (credit operations) – targeted to support lending to the real economy

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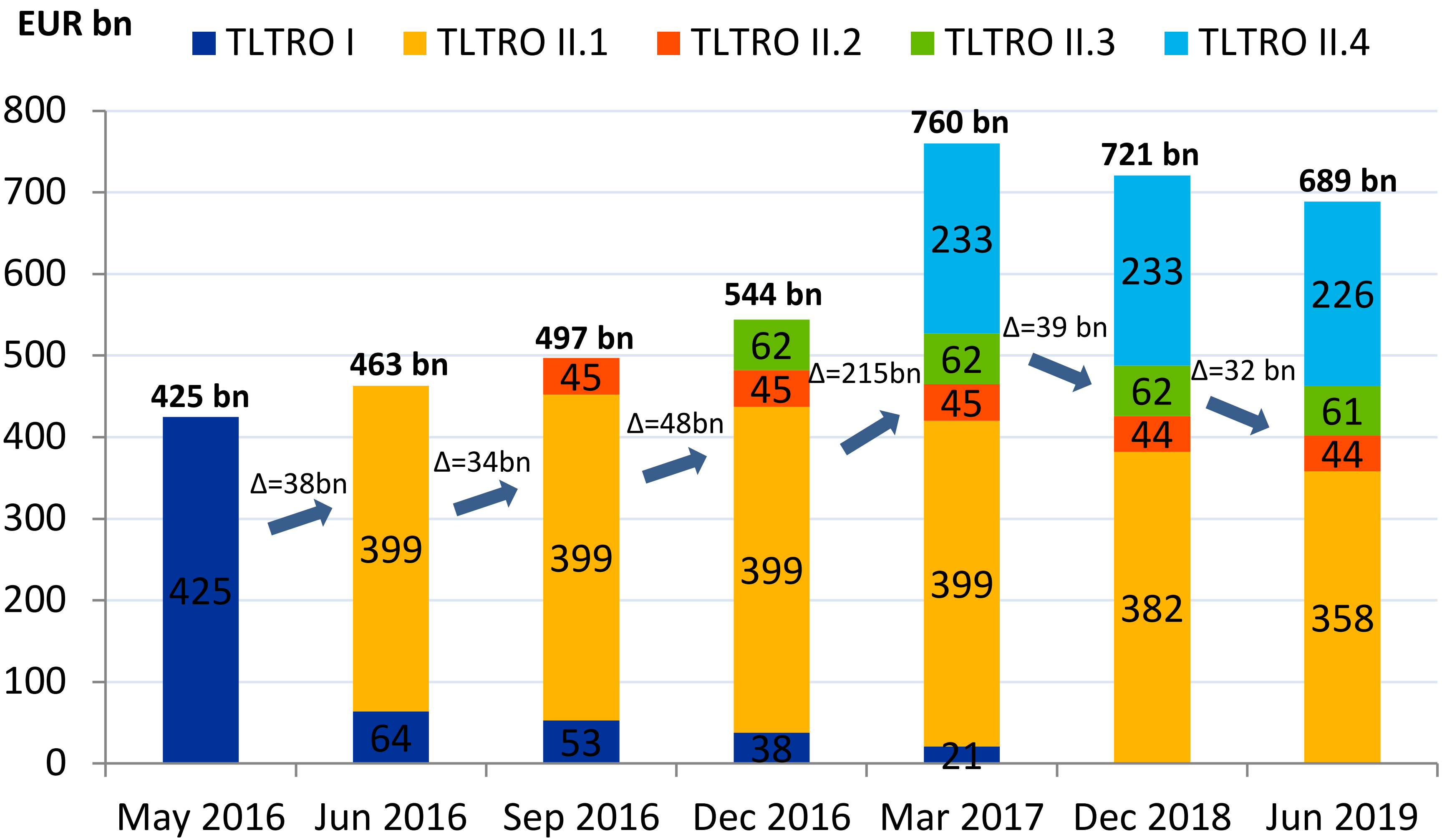
- Basic idea to link funding terms to the provision of lending to the non-financial private sector (excluding mortgages)
- TLTRO-I programme started in 2014. TLTRO-II with enhanced attractiveness started in June 2016. Last operation in March 2017, repayments as of June 2018. TLTRO III will start in September 2019.
- TLTRO II provided long-term funding (4 years maturities) at a cost between -0.4% and 0% depending on eligible net lending from 1 February 2016 to 31 January 2018.
- TLTRO III provides long-term funding (2 years maturities) at a cost between – the DF rate and the MRO rate plus 10 basis points depending on eligible net lending from 29 March 2019 to 31 March 2021.

TLTRO-take up was substantial



Source: ECB calculations

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Negative interest rates

"We expect rates to remain at their present levels at least through the first half of 2020, and in any case for as long as necessary….."

Central bank comfort zone

Zero nominal rate

- Negative rates empower other monetary policy instruments

"Economic lower bound"

- Detrimental effects on the banking sector dominate
- Negative rates have both a one-off and a persistent impact
- Rate cuts cease to provide stimulus to the economy
- Depends on banking structures and competition

"Physical lower bound"

- Large-scale hoarding of cash

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4. A comparison between then and now

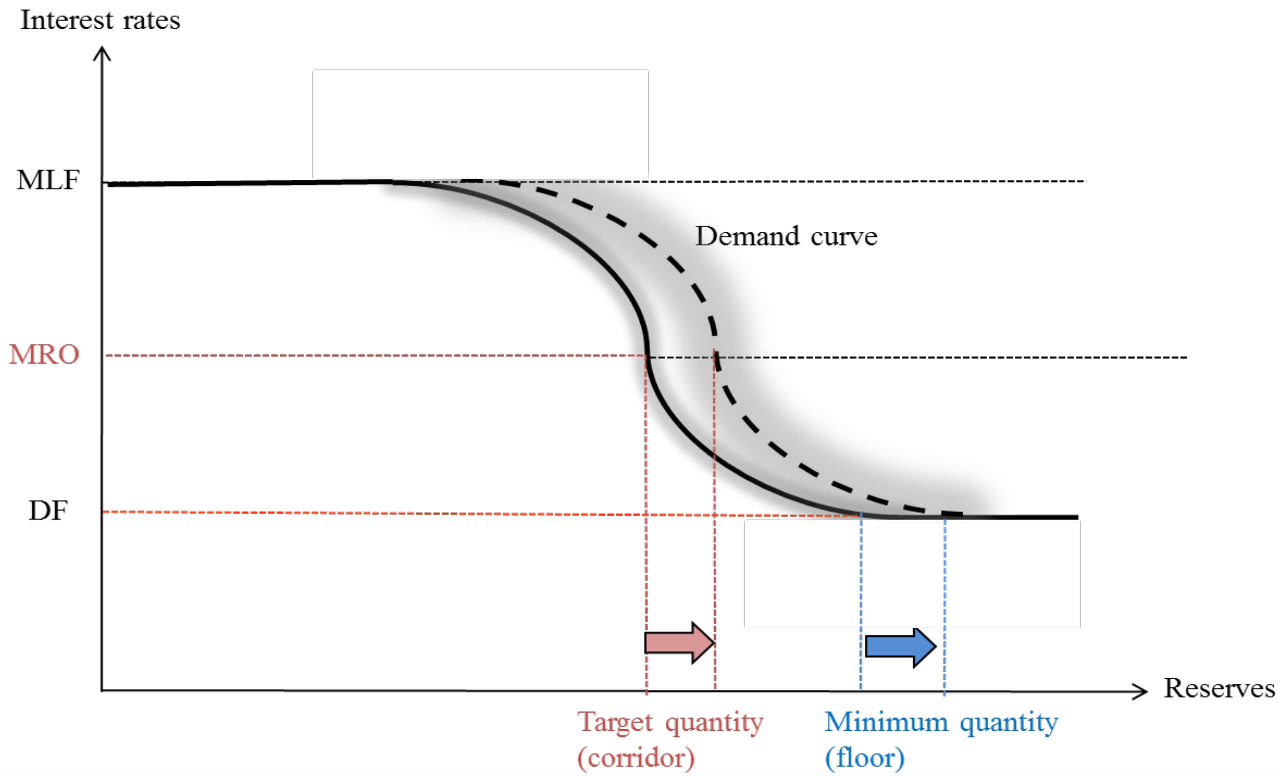
The framework in the past and now

	Pre-crisis	Current set-up
Operational target	"very short-term interest rates"; O/N unsecured EONIA seen as an implicit target	"very short-term interest rates" EONIA to be discontinued
Liquidity position/ Balance sheet	Structural liquidity deficit; lean balance sheet. Asset-side: credit operations Weekly MROs: 66% of credits	Structural liquidity surplus; large balance sheet. Asset-side: credit and outright Weekly MROs: 1% of credits
Counterparty framework	Credit institutions (Open market Operations & SF)	Credit institutions (Open market operations & SF)
Collateral framework	Broad and uniform	Broad(er) and uniform, with a few exceptions
LOLR modalities	Marginal lending facility (MLF)+ ELA	To some extend FRFA on MRO/LTRO + MLF + (ELA)

From a corridor to a floor system

- Demand driven provisions of reserves at MRO rate (responding to bank reserves needs);
- Lean balance sheet, growth in line with growth of i.e. banknotes

- Supply driven provision of reserves at the DF rate
- Large balance sheet in line with asset side measures (i.e. APP, long term credit operations)



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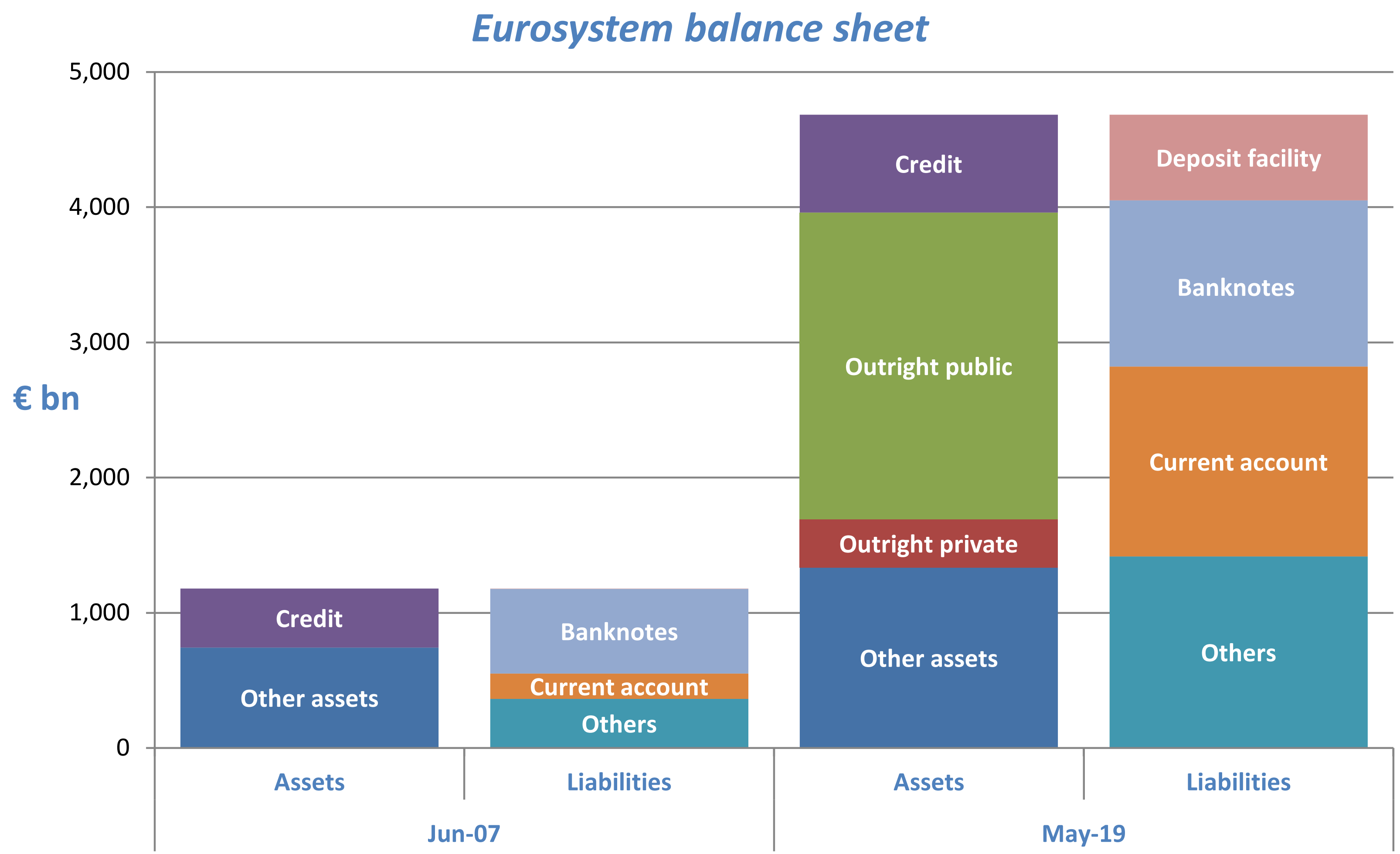
5. The impact of ECB monetary policy on the Eurosystem balance sheet

Monetary policy – through the lenses of the balance sheet



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