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# Session: Low interest rate policy and nonstandard policy measures

Volker Wieland

IMFS-CFS Conference „The ECB and its Watchers XVI“

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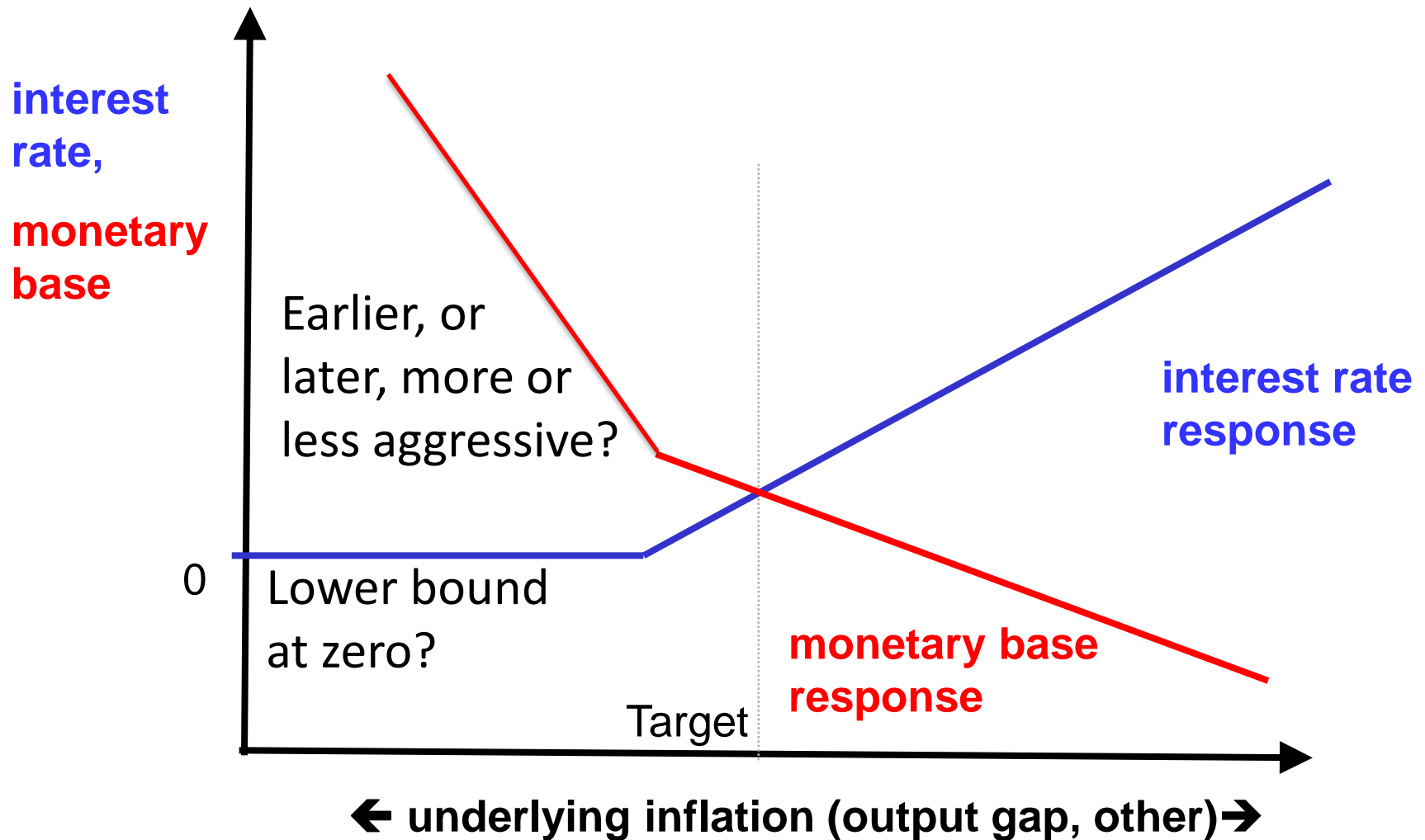
# Questions

1. Quantitative easing (QE): Role and effect?
2. ECB extends QE to sovereign debt: Needed? Risks?
3. How can €-zone exit crisis and ECB exit QE/low rates?
4. Risk of secular stagnation?

# My comments (summary)

1. **QE:** natural continuation when nominal rates hit zero.  
→ Works via expected future rates, premia, asset prices, exchange rate.
2. **ECB sovereign debt purchases:** Impact of earlier measures on rates already sufficient given outlook.  
→ Risk of getting consolidation/reform policy off track.
3. **€ crisis:** Monetary policy only provides cushioning.  
→ Macro adjustment is key. Stick to consolidation/reform path. But major ongoing political challenge!
4. **Stagnation:** Diverse performance points to policy.  
→ On/off consolidation/reform + monetary accommodation = low growth/low rates.

# 1. Optimal QE (Orphanides/Wieland, IJCB 2000)

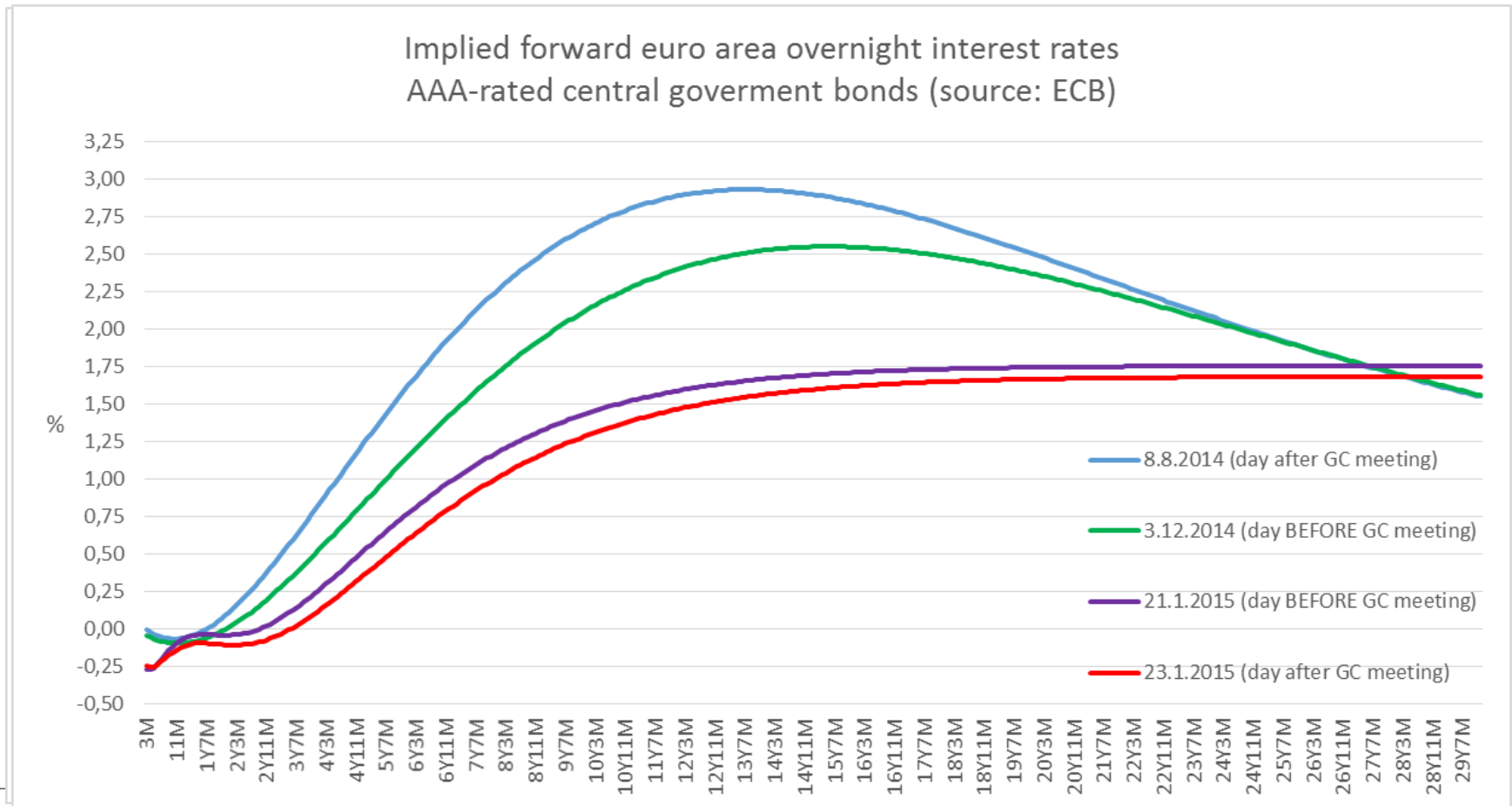


## 2. Transmission channels

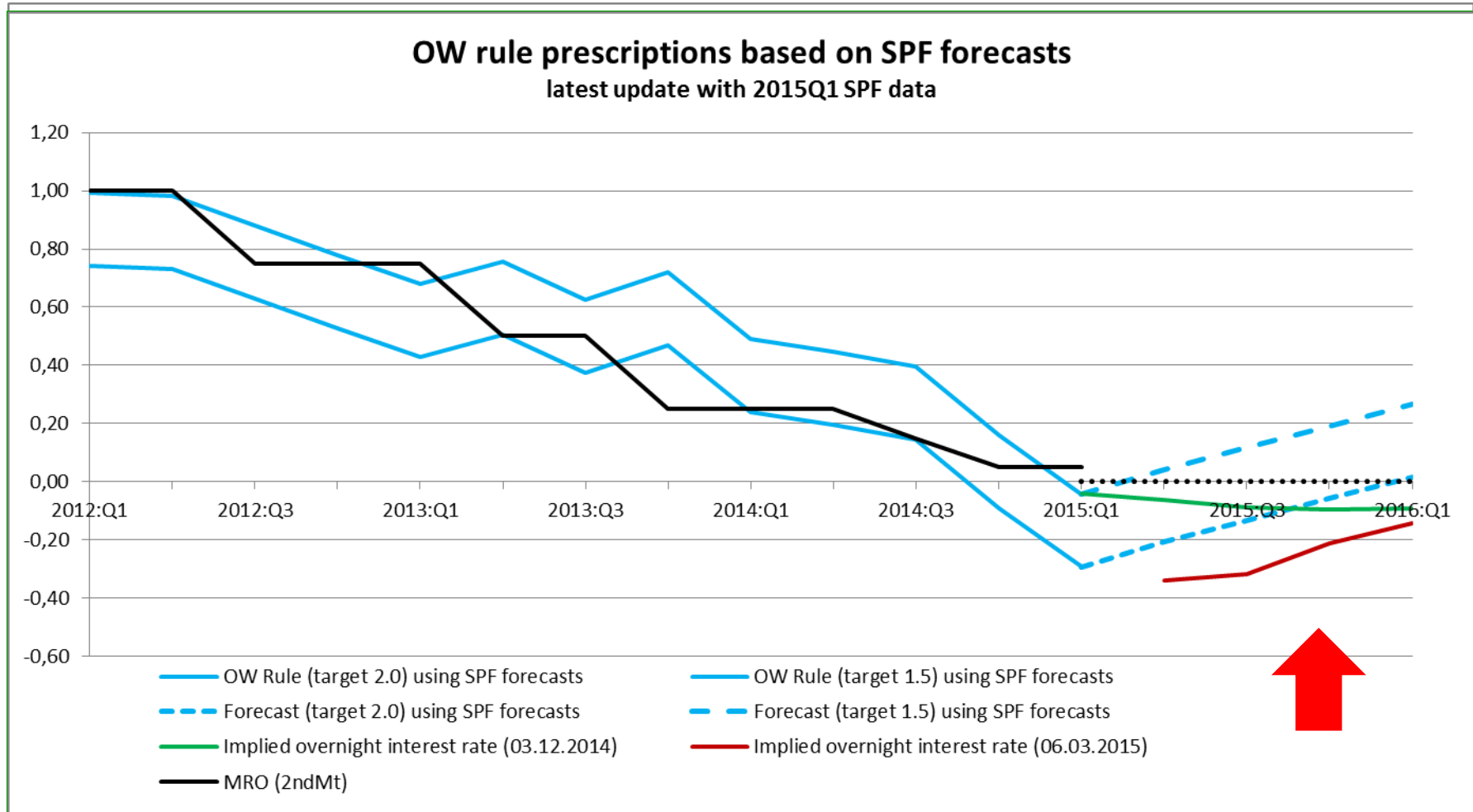
- Normally, asset purchases affect economy via changes in interest rates.
- With short rate at zero: QE can still lower medium to long rates via expected future short rates, term and risk premia.
- With constant zero rates: Direct effects of QE possible due imperfect substitutability of assets .
  - Best known direct effect: portfolio-balance effect via exchange rate premia. Depreciation can always be defended.
  - Other assets: stocks, bonds, real estate. Increase in asset prices has wealth effect.
  - Bank lending improves due to reduced stress in bank funding markets.

# 4. Long-rates and anticipated futures rates have come down.

- Policy actions: MRO 5bp, deposit rate -20 bp. TLTRO, 15bp for 4 years, QE for covered bonds and ABS.



# 5. Policy impact sufficient relative to past reaction to outlook even before sovereign QE.



## 6. Financial stability risk?

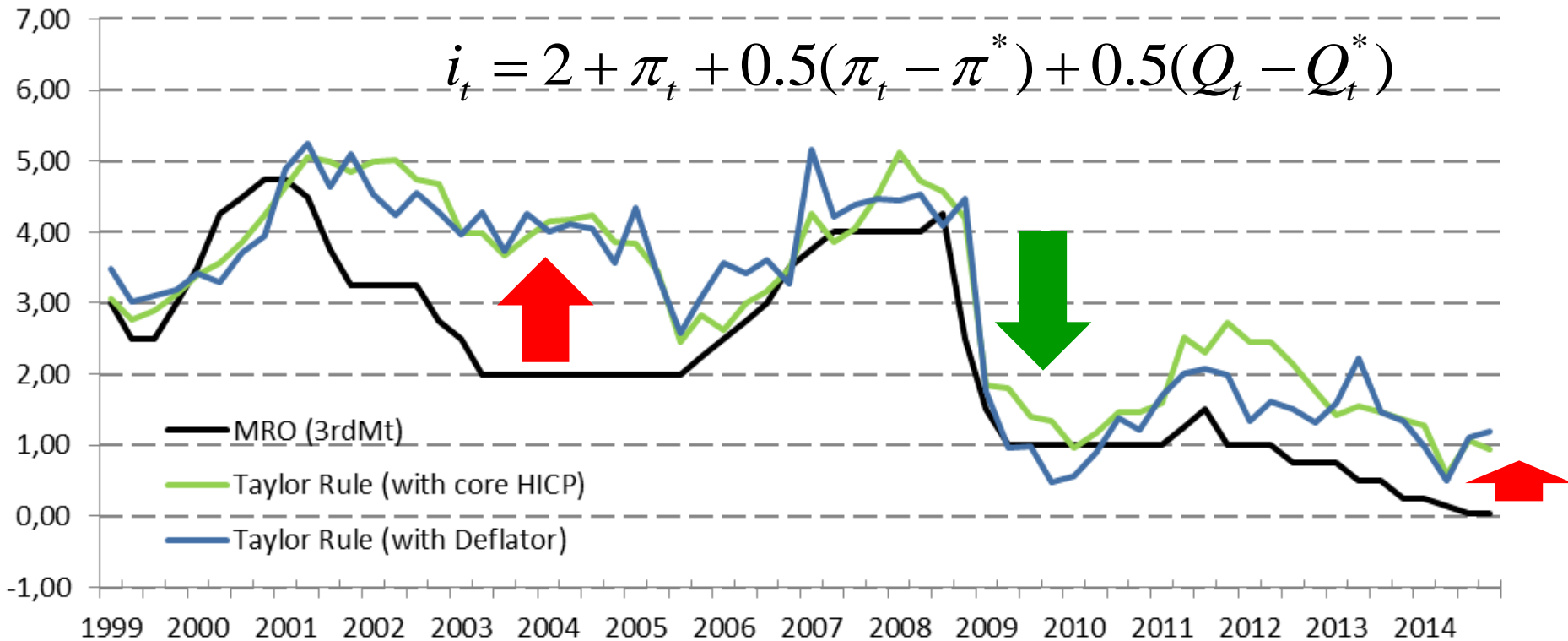
- QE is supposed to raise asset prices. The wealth effect is meant to boost demand.
- Some see the next bubble followed by the next crash when ECB tries to exit.
  - „Thomas Mayer: FAZ, last Sunday, the end of paper money is only one financial crisis away“.
  - I would not go that far, but there are risks, and the „relax, macro-pru will handle it“ view seems complacent.
- Rates: Taylor's rule - „Rates too low for too long“.
- Asset prices: House prices converging. Stocks up!
- Credit: rel. GDP converging.



# 7. Financial Stability Risk: Rates too low too long (relative to Taylor rule)?

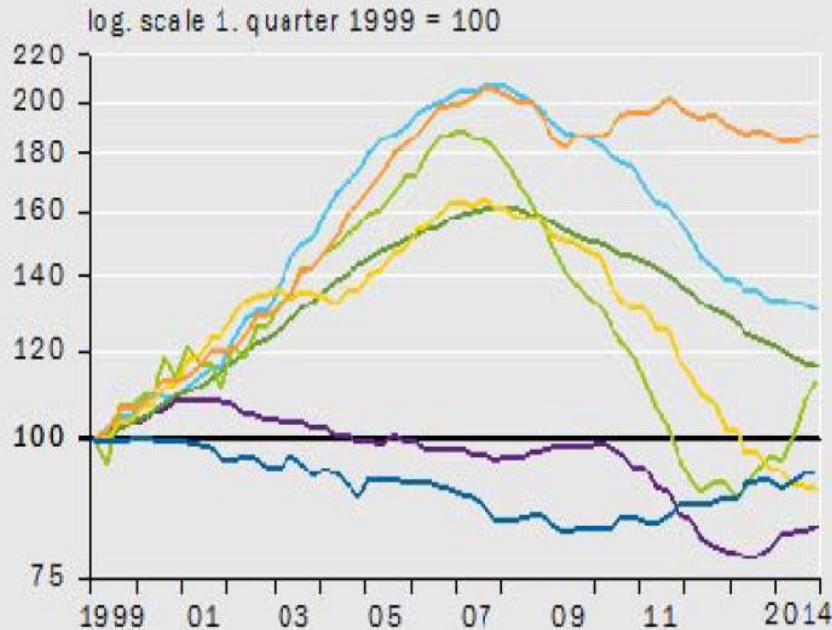
Taylor Rule for the euro area with ECB real-time data and AMECO nowcasts

$$i_t = 2 + \pi_t + 0.5(\pi_t - \pi^*) + 0.5(Q_t - Q_t^*)$$

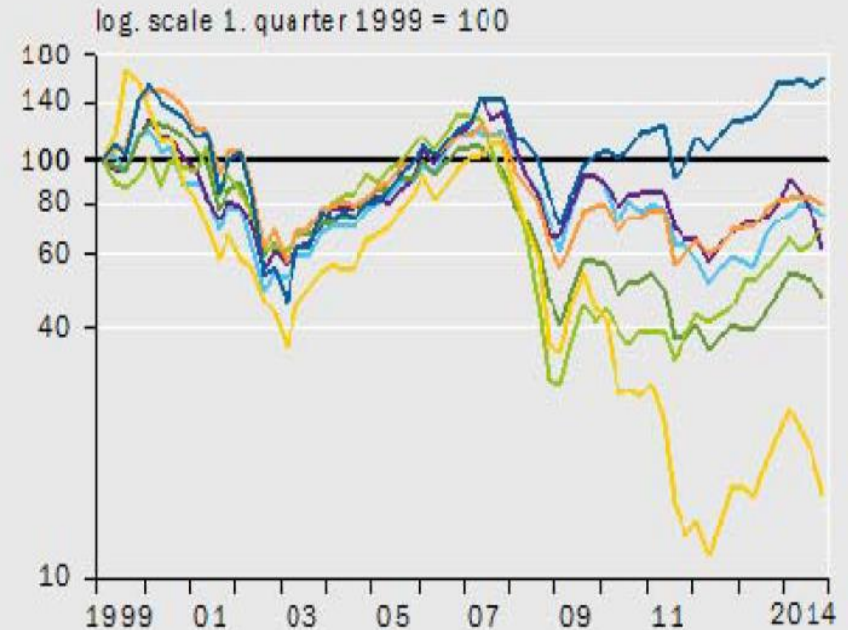


# 8. Financial stability risk: Asset price boom?

House price indices<sup>1</sup>



Stock indices<sup>1</sup>

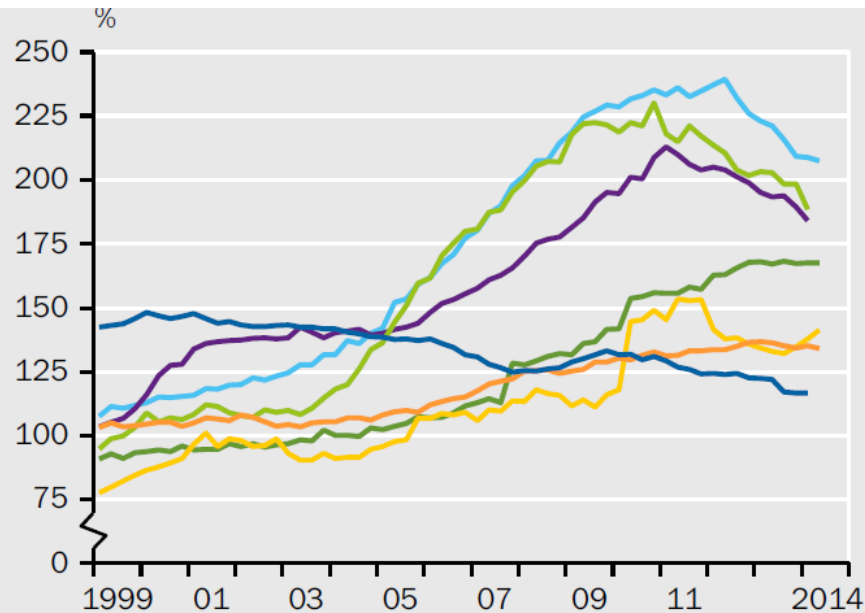


**Germany, France, Greece, Ireland, Italy, Portugal, Spain**

- House prices primarily converging. Indications of excessive growth in stock prices.

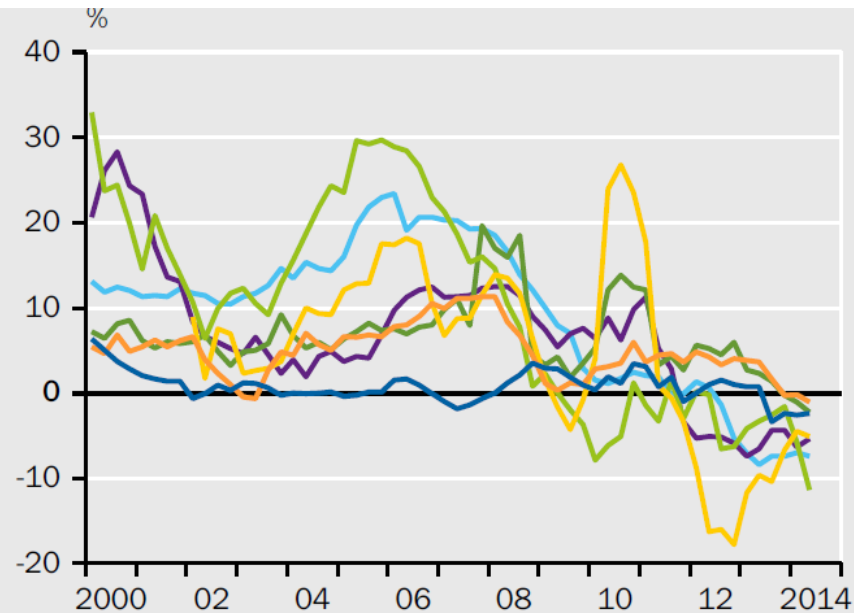
# 9. Financial stability risk: Credit boom?

## Credit-GDP ratio



Germany, France, Greece, Ireland, Italy, Portugal, Spain

## Credit growth

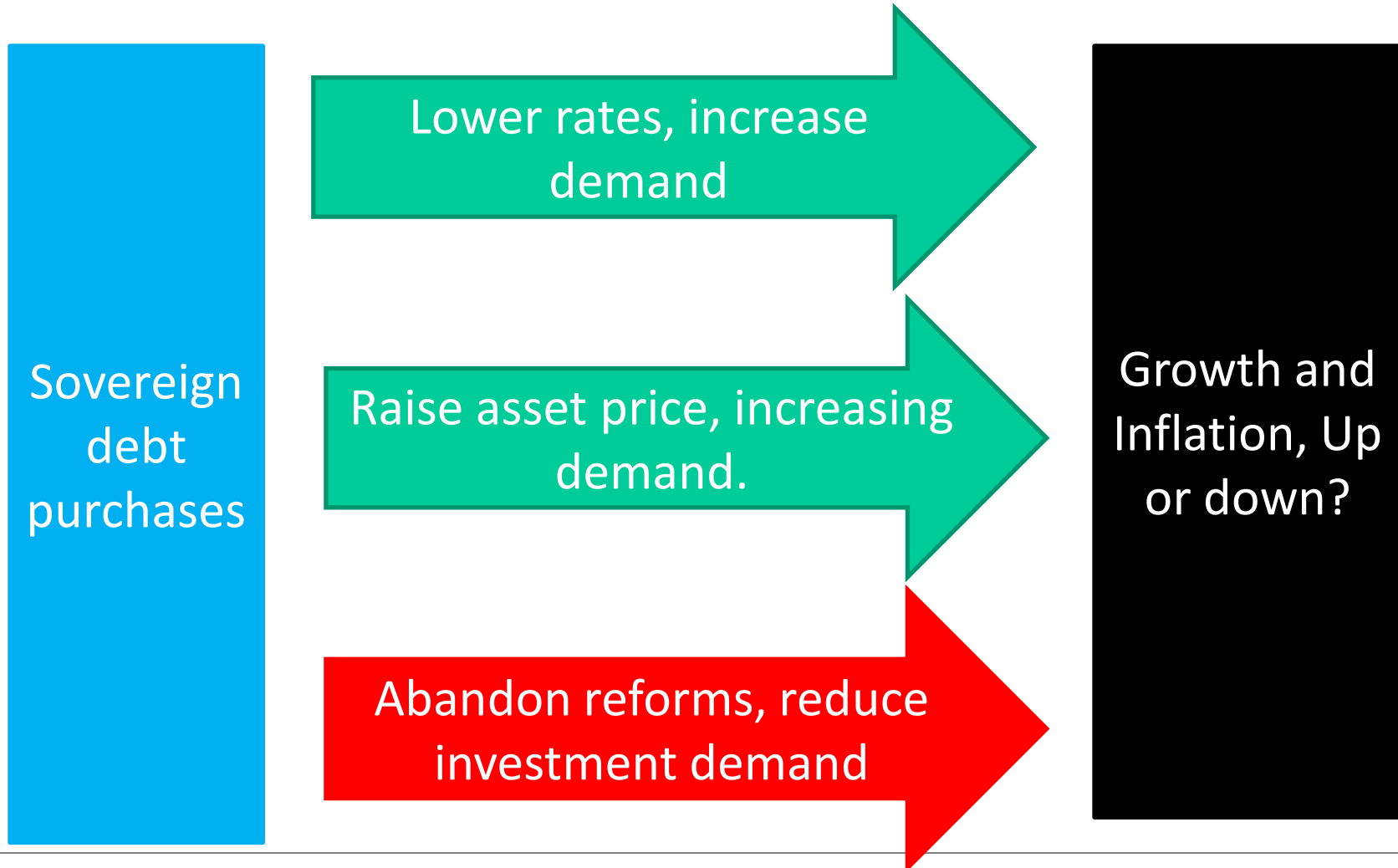


- Credit-GDP ratios characterized by converging development.

## 10. Sovereign commitment to consolidation/reform?

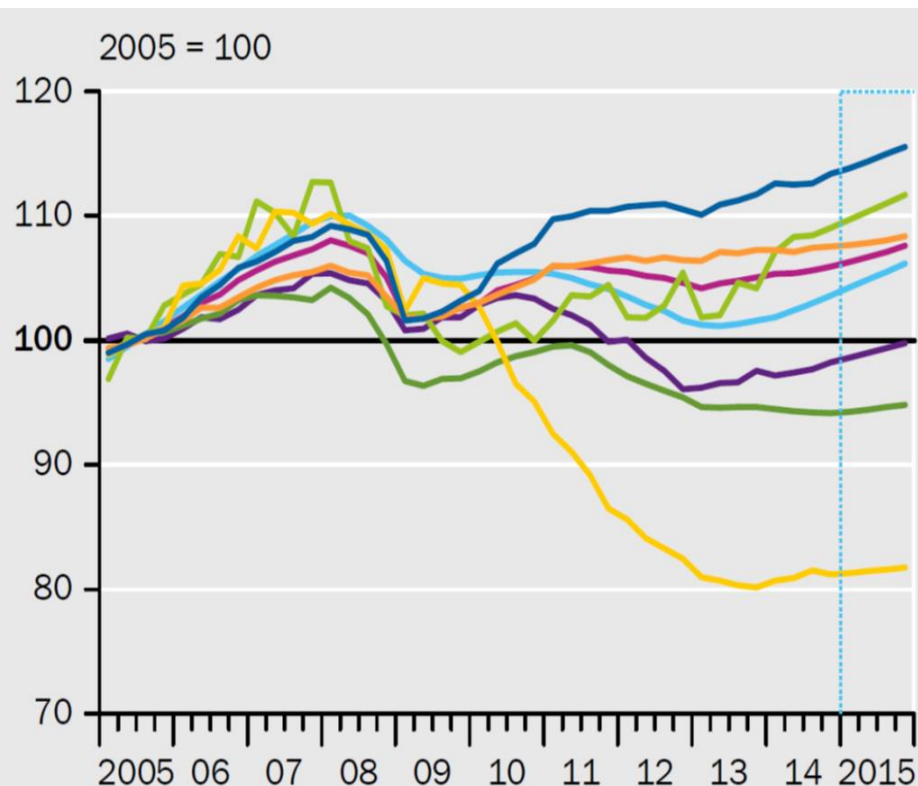
- ECB needs to take into account the reaction of governments to ECB actions in estimating the sign and magnitude of the impact of these actions on growth and inflation.
- Excluding certain channels in forecasting the impact of policy actions would violate the ECB's mandate.
- Low rates and sovereign debt purchases may give governments room to delay or abandon structural reforms that would improve long-run growth and trigger new investments now.

# 11. QE transmission channels

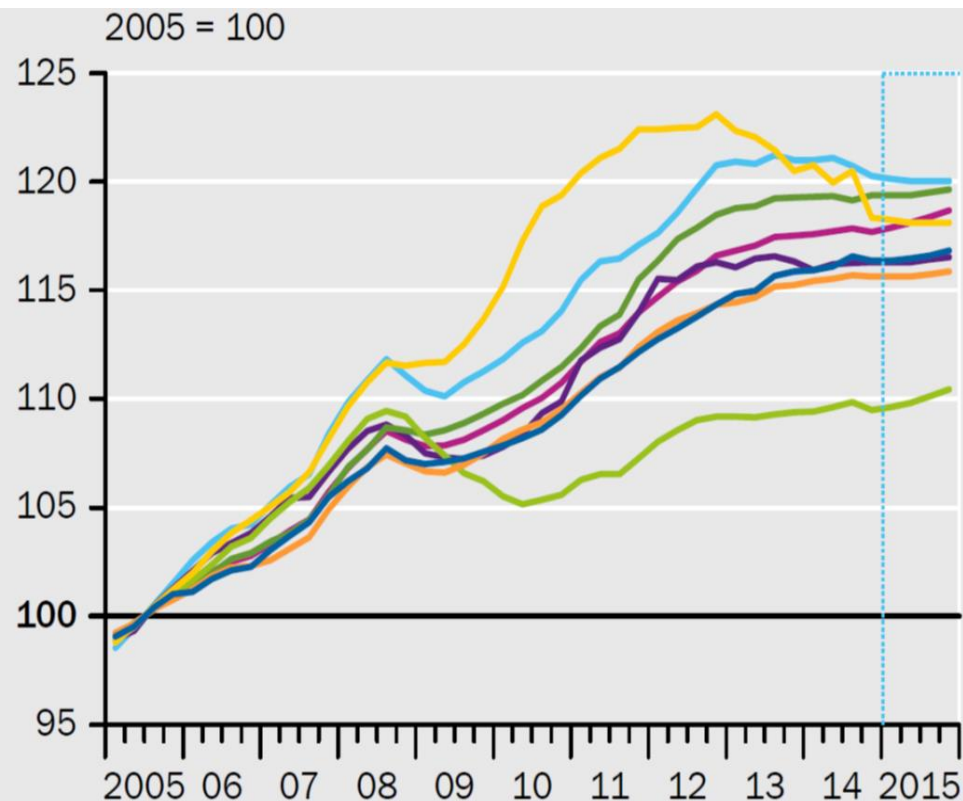


# 12. ECB can provide cushion, but key is macro adjustment in crisis countries.

## GDP



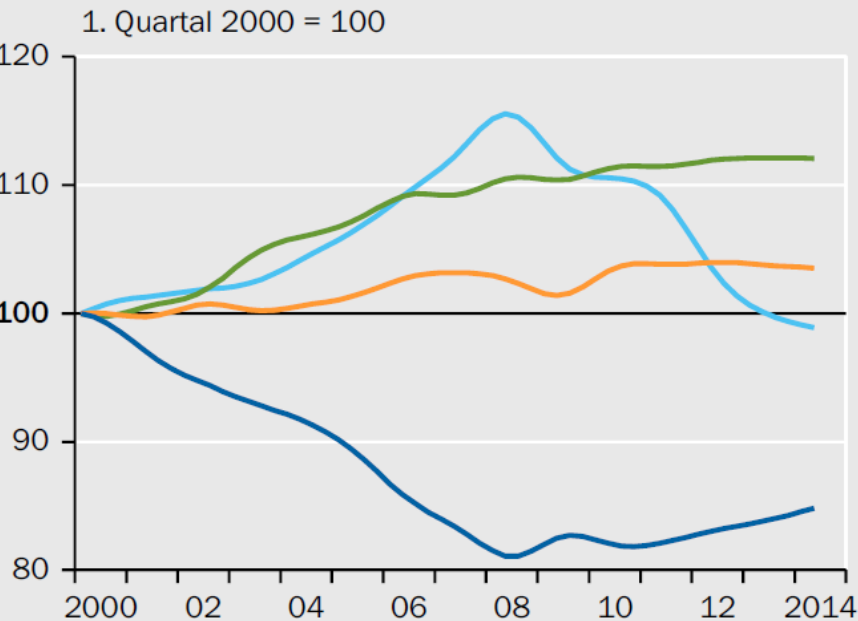
## HICP Level



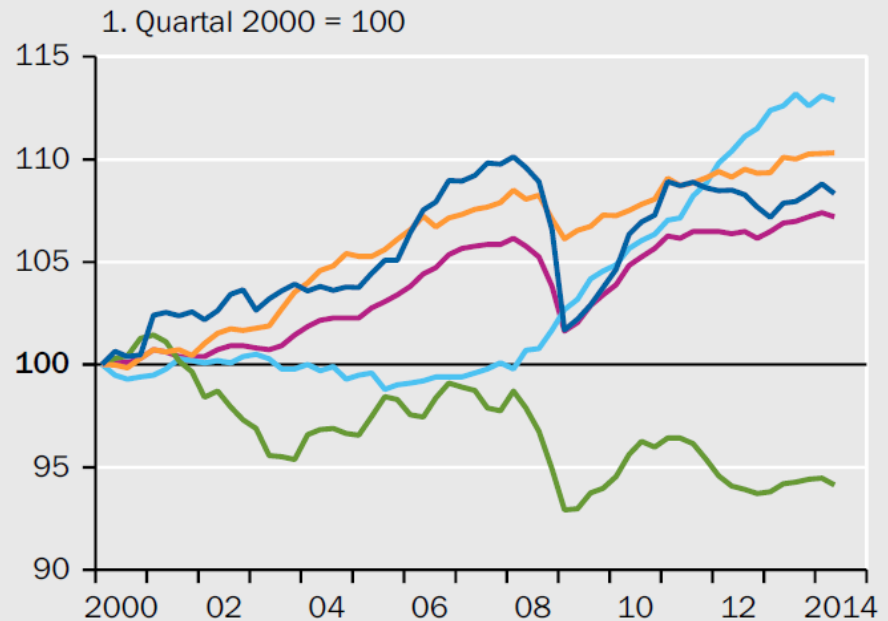
**Germany, France, Greece, Ireland, Italy, Portugal, Spain**

# 13. Competitiveness and productivity: some convergence, some divergence.

Effective real exchange rate vs euro area (unit-labor-cost based)



Labor productivity per employee



**Germany, France, Italy, Portugal, Spain**

**Italy: long-term decline in competitiveness started well before crisis and still needs to be reversed.**

# 14. Secular stagnation?

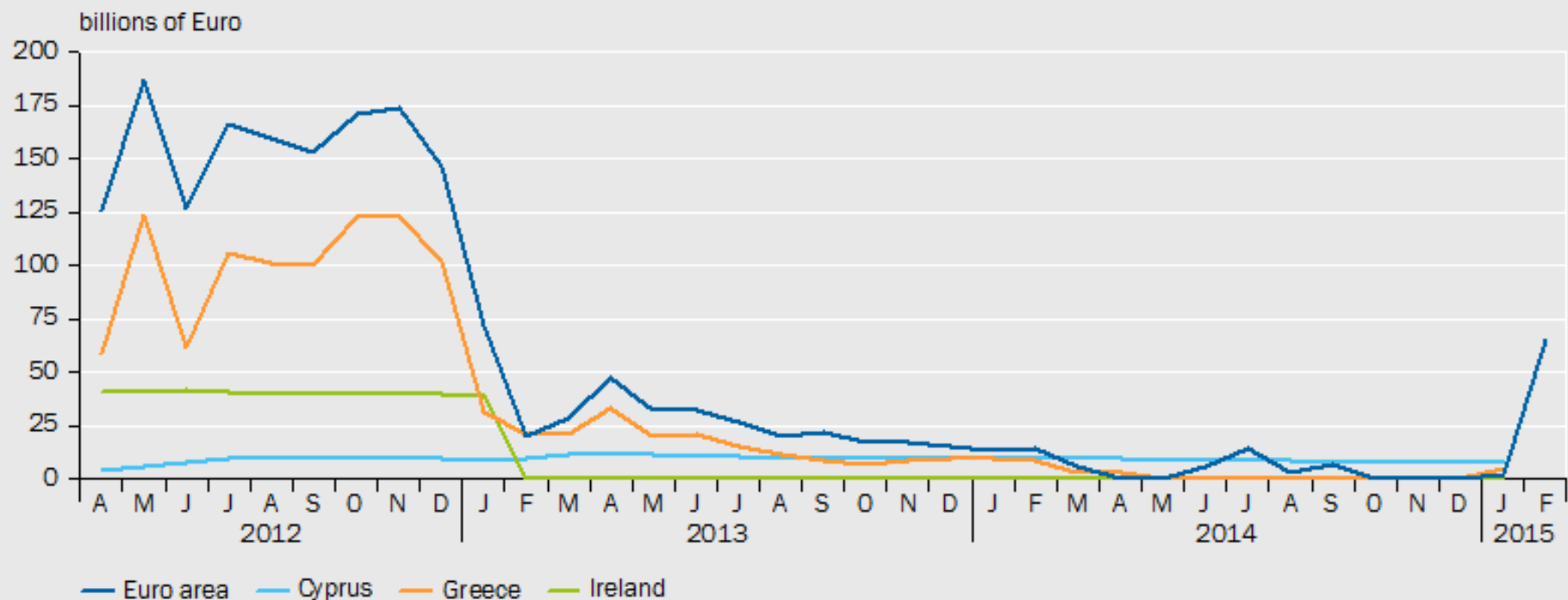
- Secular stagnation, case A:
  - Savings glut, deleveraging, low rates, zero bound, real rate too high, output stays below potential for a long time.
- Secular stagnation, case B:
  - Low growth, budgetary stress, reform pressure, central bank buys up „distressed“ sovereign’s debt, sovereign postpones or abandons consolidation/reform path, persistent low growth or decline.
- Ongoing major political challenge to euro area’s consolidation/ reform strategy!
  - Key role for ECB with QE and ELA! Stick to the rules.



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# Extras

## Emergency Liquidity Assistance (ELA) for selected Euro area member states<sup>1</sup>

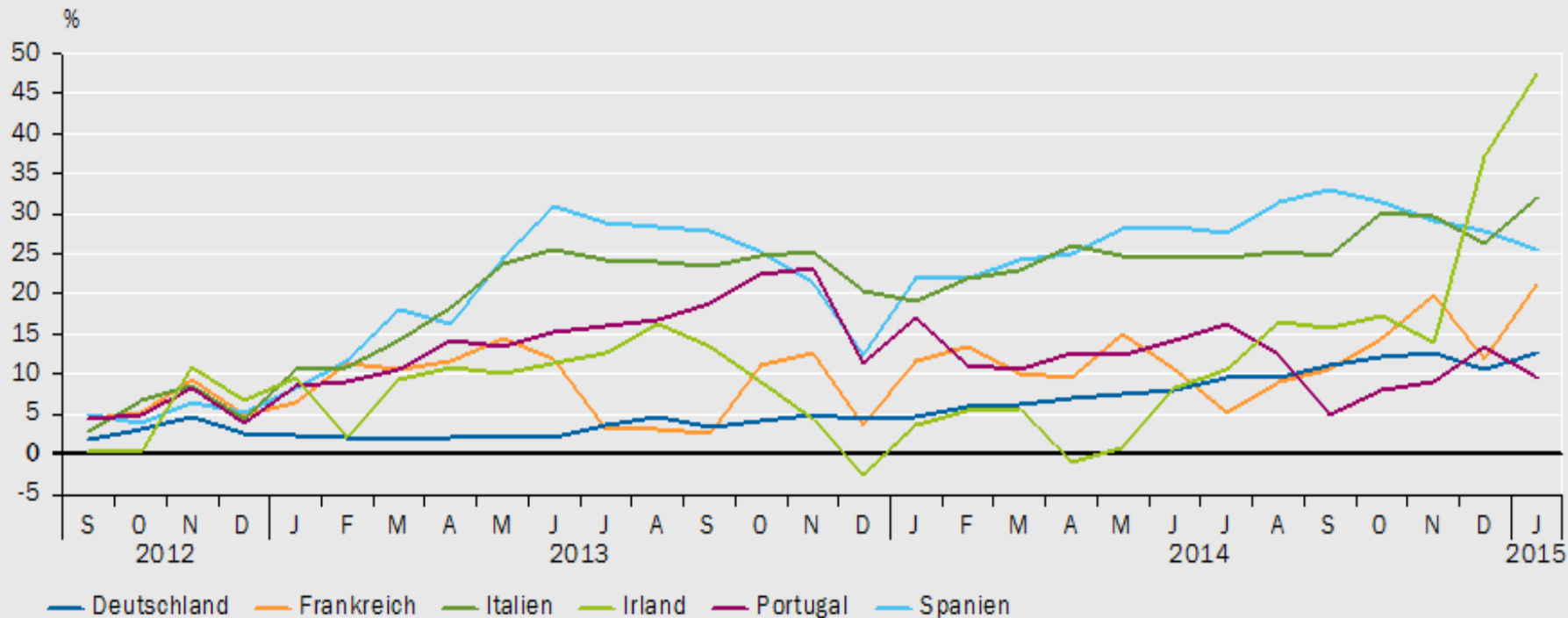


1 - Difference between the respective value at the end of each month and the base value prior to the balance sheet adjustments in April 2012.

Sources: ECB and national central banks

SVR-15-054

# Zuwachs an von Banken gehaltenen Wertpapieren öffentlicher Haushalte ausgewählter Mitgliedstaaten des Euro-Raums<sup>1</sup>



1 - Prozentuale Veränderung der von Banken gehaltenen Wertpapiere zum August 2012.

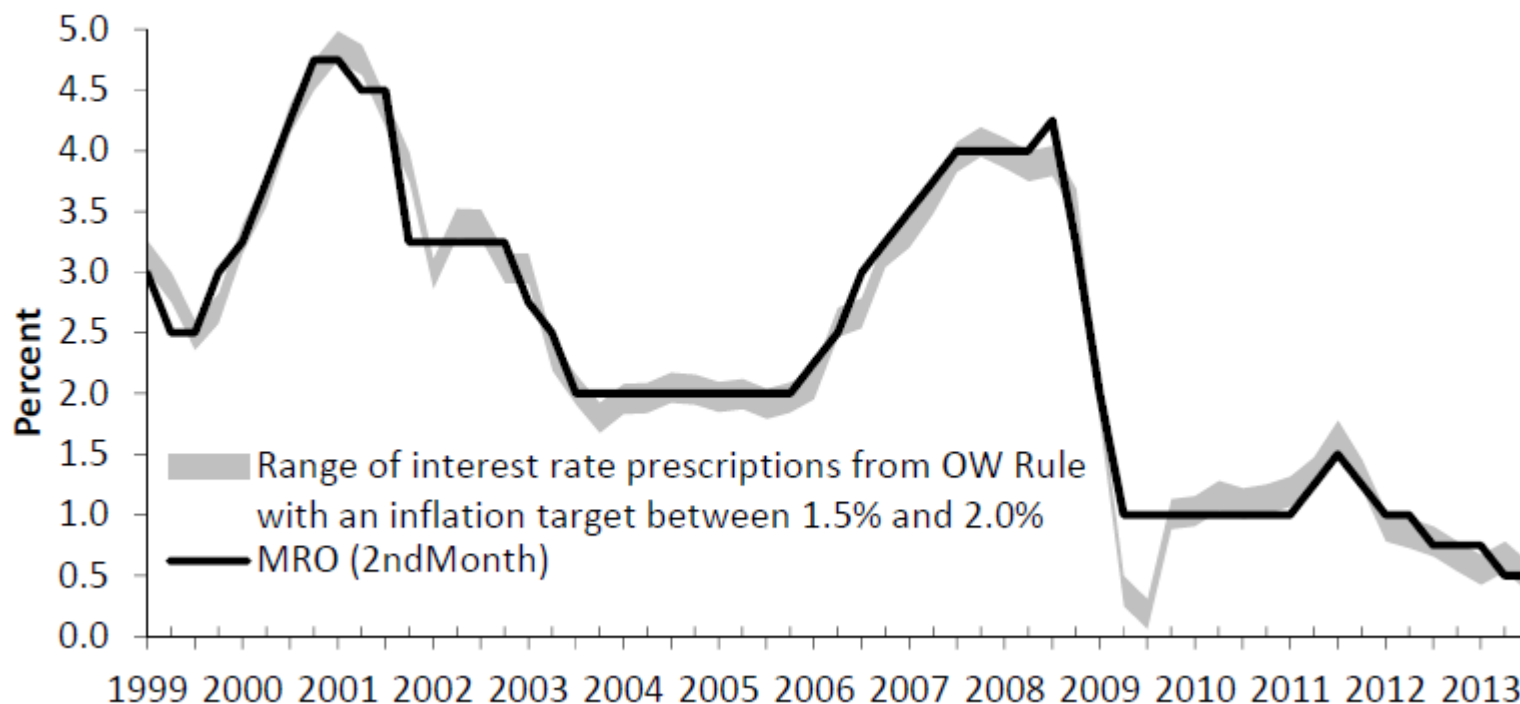
Quelle: EZB

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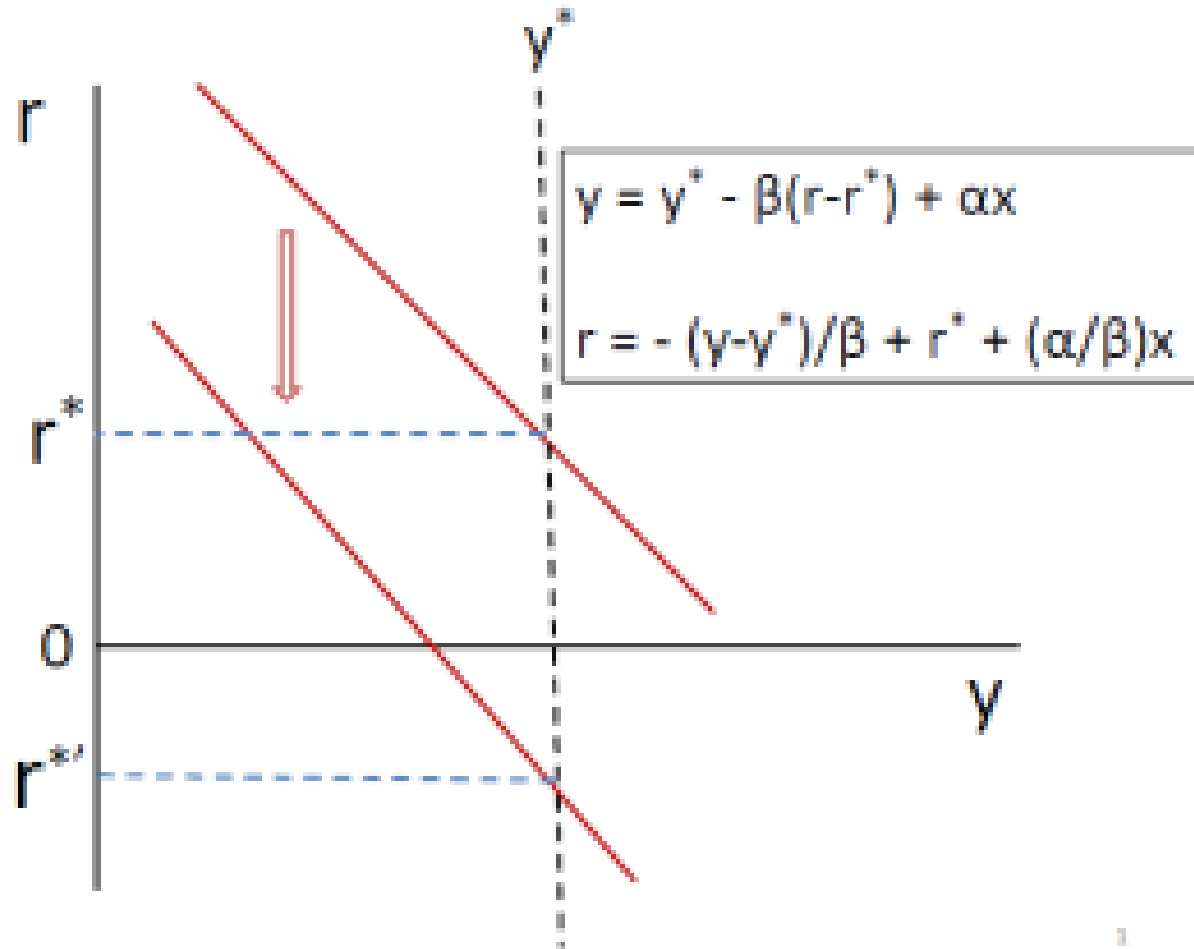
# ECB interest rate reaction to near-term inflation and growth forecasts.

$$i_t - i_{t-1} = 0.5(\pi_{t+3|t} - \pi^*) + 0.5(q_{t+2|t} - q_{t+2|t}^*)$$

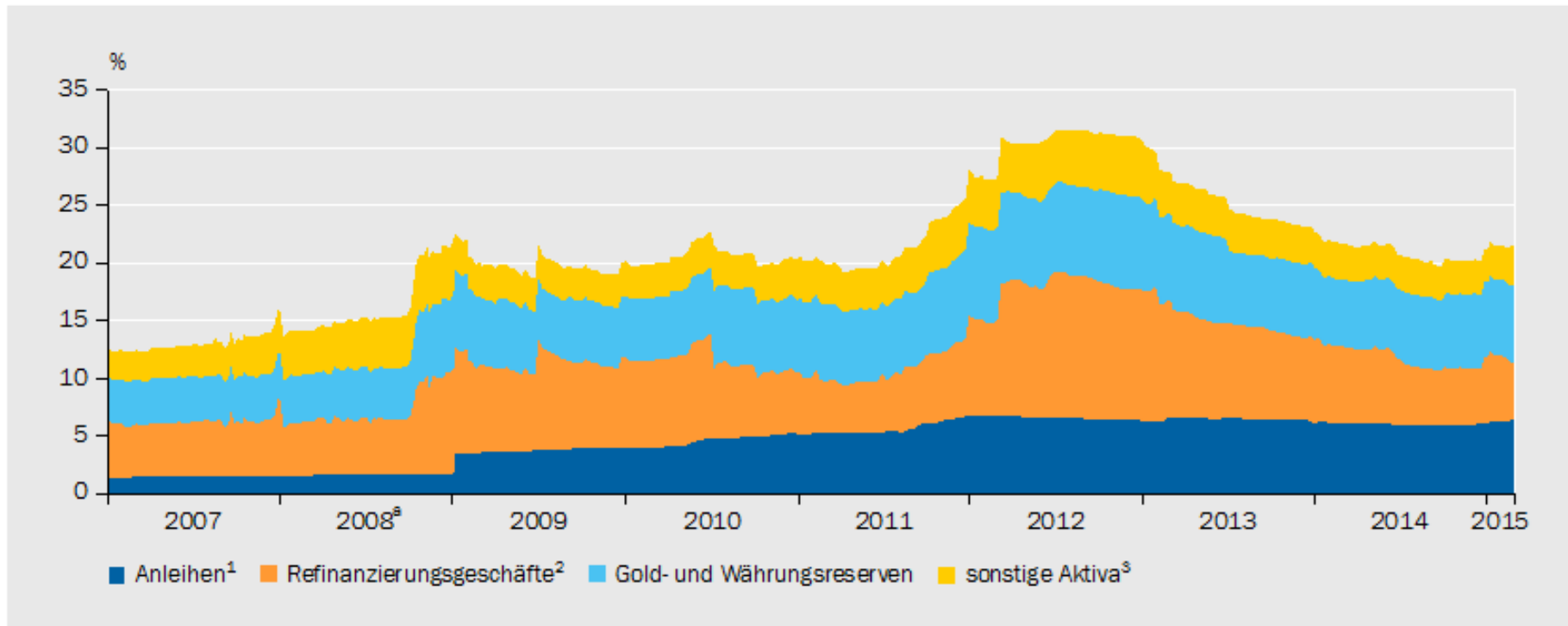
Figure 1: MRO Rate versus Orphanides and Wieland (2013) Rule with SPF Forecasts



# Secular stagnation?



## Struktur der EZB-Aktiva in Relation zum nominalen Bruttoinlandsprodukt



1 – Von Emittenten aus dem Euro-Raum, einschließlich der Käufe von Staatsanleihen für geldpolitische Zwecke. 2 – Hauptrefinanzierungs- und längerfristige Refinanzierungsgeschäfte. 3 – Einschließlich sonstiger Kredite an Banken. a – Ende 2008: Änderung der Zuordnung von „sonstige Aktiva“ in die Kategorie „Anleihen“.

Quellen für Grundzahlen: Eurostat, EZB

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