ECB NORMALIZATION: THE BALANCE SHEET

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The ECB and its Watchers
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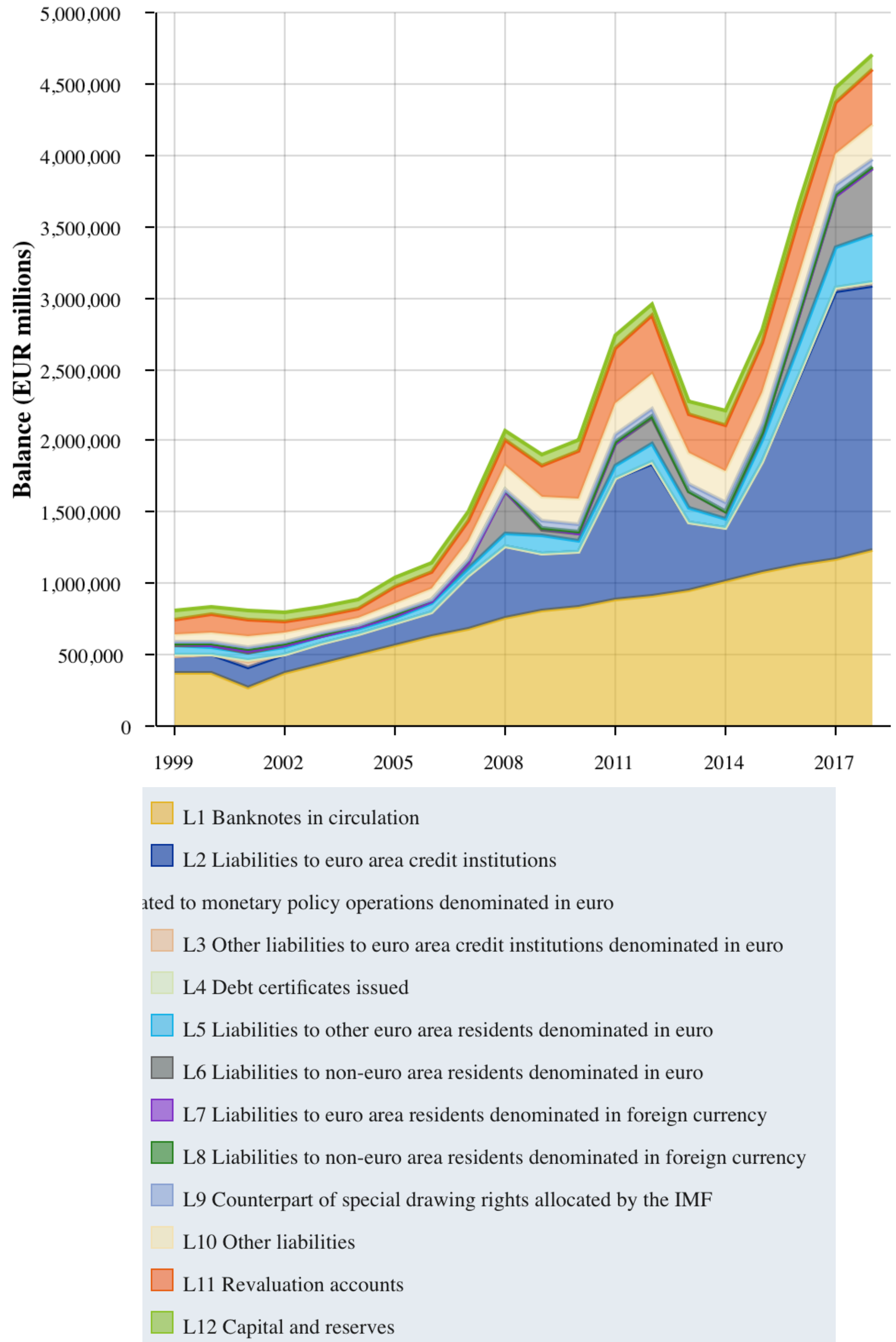
Canonical central-bank balance sheet

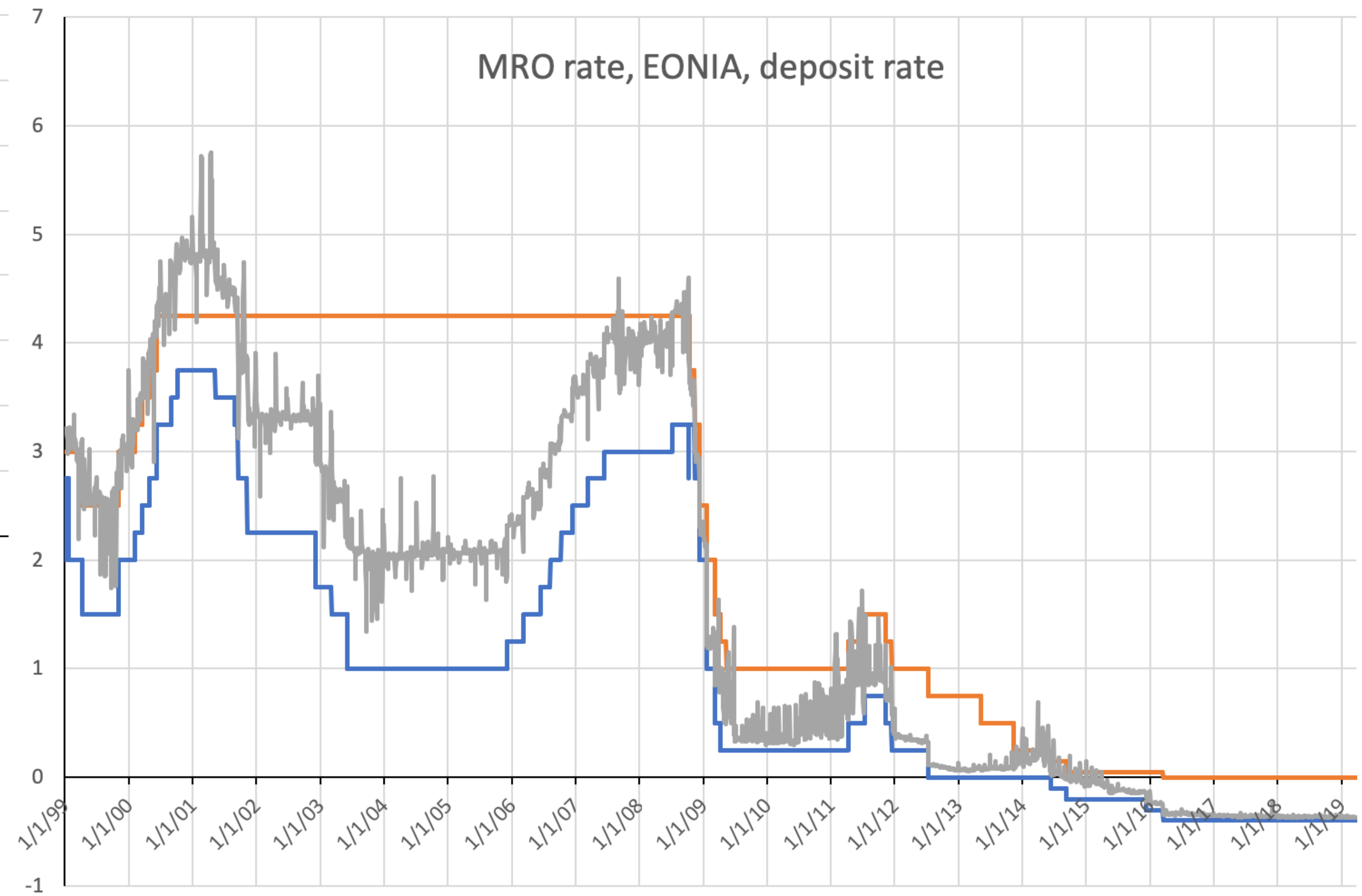
Assets	Liabilities
Short-term safe bonds	Net worth
Long-term safe bonds	Currency
Risky assets (incl. foreign)	Bank reserves (deposits)
Lending programs	C.B. swap lines

Source: Reis (2019)

Size of the balance sheet

- **Lessons:** Satiate demand for central-bank deposits by banks, central-bank interest-paying digital money





Source: ECB SDW

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- **Why?** Money markets did not close, communication on interest on deposits was seamless, automatically absorb liquidity shocks, Friedman rule.

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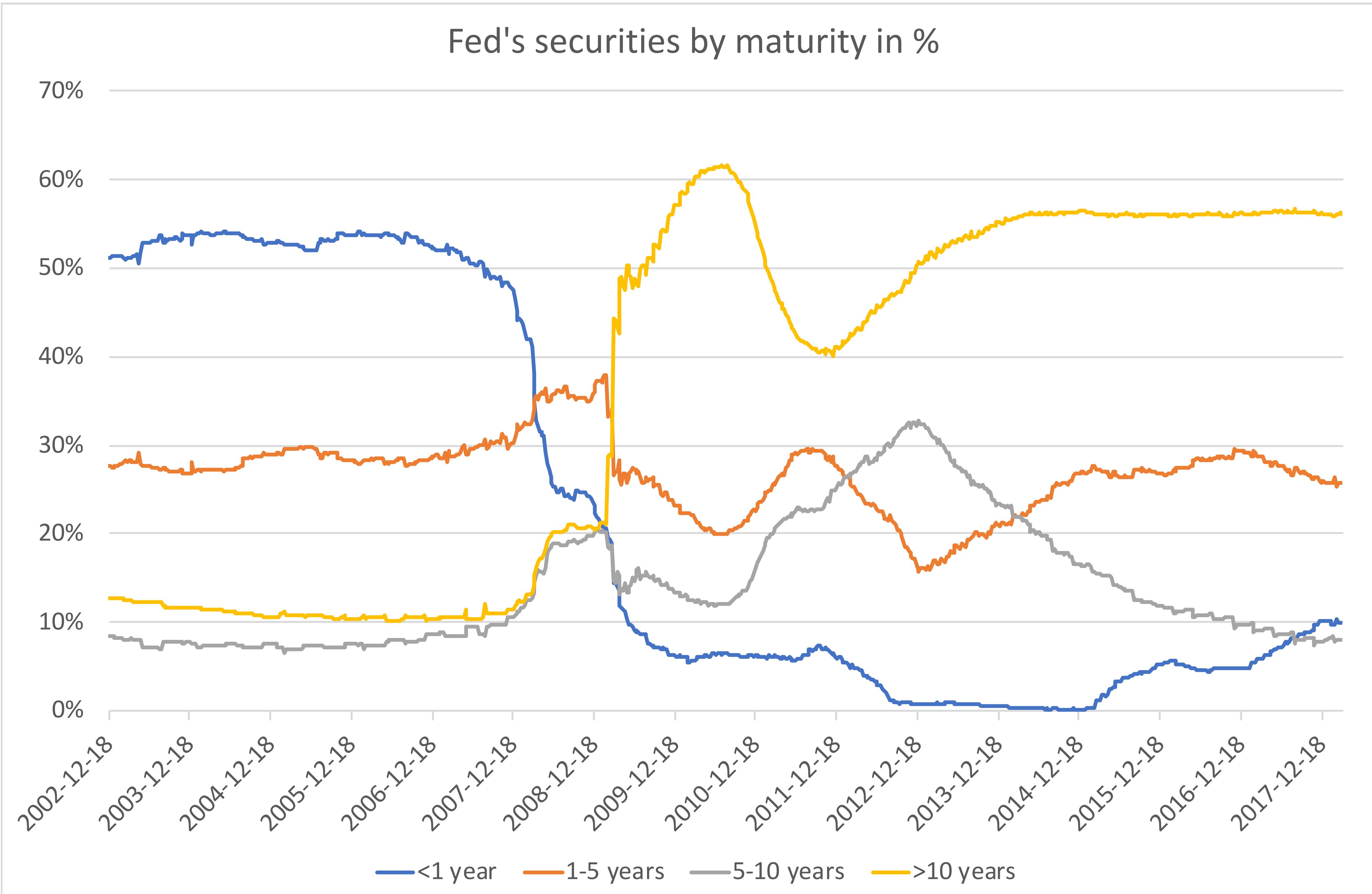
- **Why?** Money markets did not close, communication on interest on deposits was seamless, automatically absorb liquidity shocks, Friedman rule.

- **How for ECB?** move from structural liquidity deficits to minimal structural liquidity surplus: just so interbank rate is close to deposit rate. Half way compromise is to keep full allotment in MRO auctions.

Composition of assets

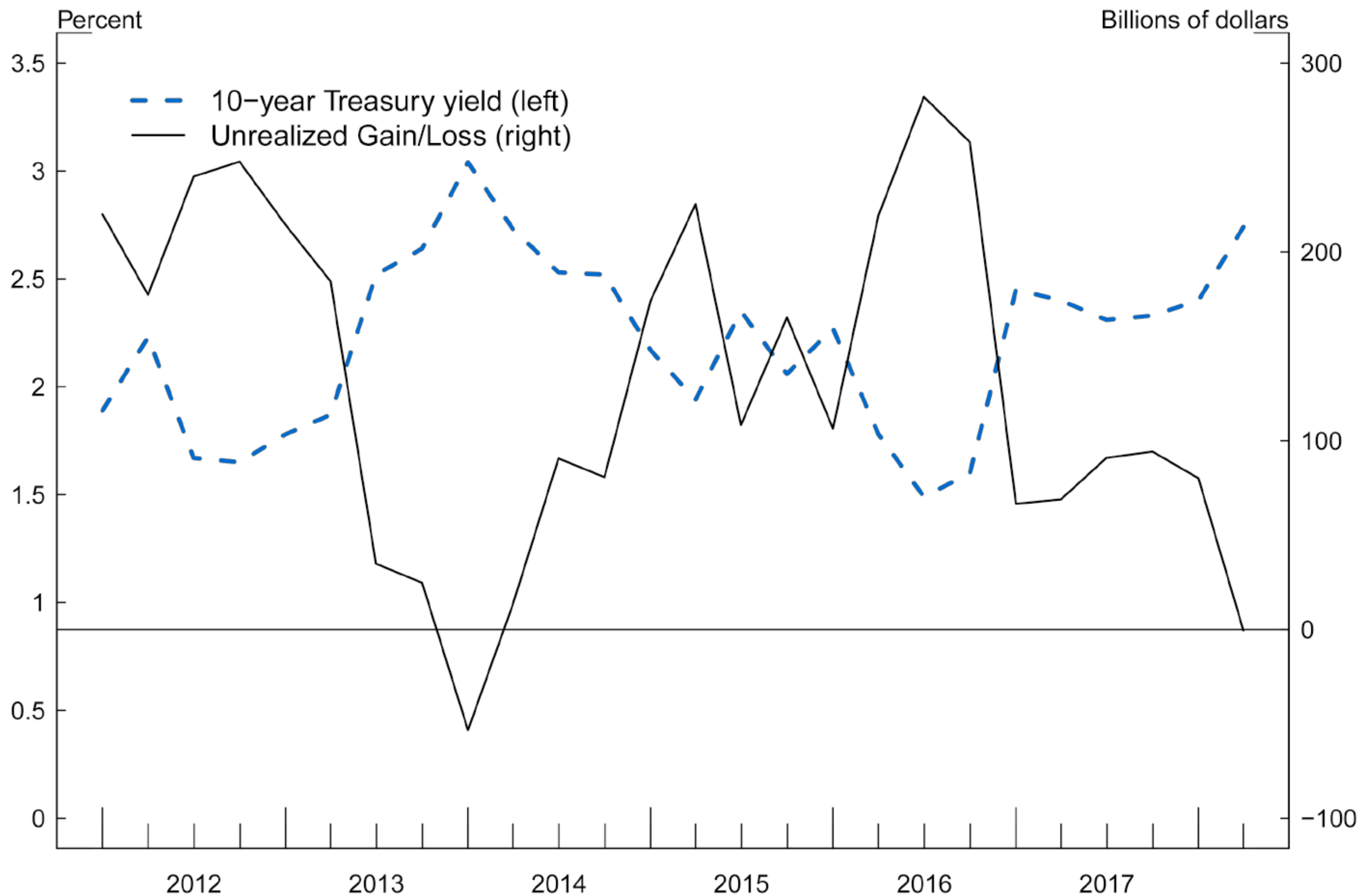
- **Lessons:** with (i) unmatched assets and liabilities



Source: Federal Reserve H.4.1

Composition of assets

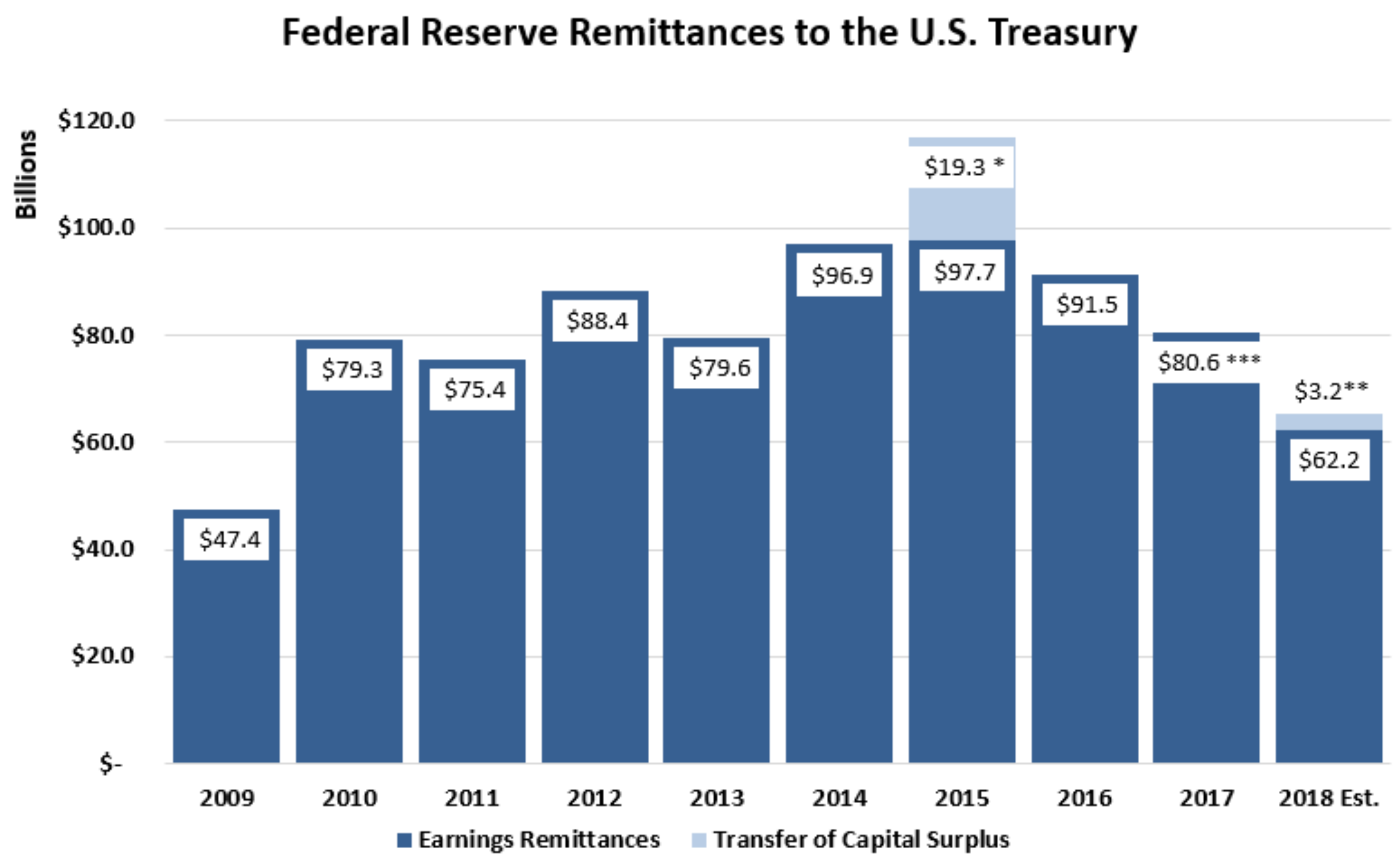
- **Lessons:** with (i) unmatched assets and liabilities, (ii) comes interest rate risk



Source: Bonis, Fiesthulmel, Noonan, 8/13/18, FEDS note

Composition of assets

- **Lessons:** with (i) unmatched assets and liabilities, (ii) comes interest rate risk, (iii) that accounting schemes only smooth but do not eliminate.



* The Reserve Banks transferred to the Treasury $19.3 billion from their capital surplus on December 28, 2015, which was the amount necessary to reduce aggregate Reserve Bank surplus to the $10 billion surplus limitation in the Fixing America's Surface Transportation Act.
** The Reserve Banks transferred to the Treasury $3.175 billion from their capital surplus in 2018, of which $2.5 billion was the amount necessary to reduce aggregate Reserve Bank surplus to the $7.5 billion surplus limitation in the Budget Act and $675 million was the amount necessary to further reduce aggregate Reserve Bank suprlus to the $6.825 billion surplus limitation in the Economic Growth Act.
***On January 29, 2019, the amount of 2017 earnings remittances was corrected to $80.6. It was incorrectly listed as $80.2.

Source: Federal Reserve press release, 1/10/2019

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- **Why?** Income risk exposes "solvency", which is about fiscal support and independence.

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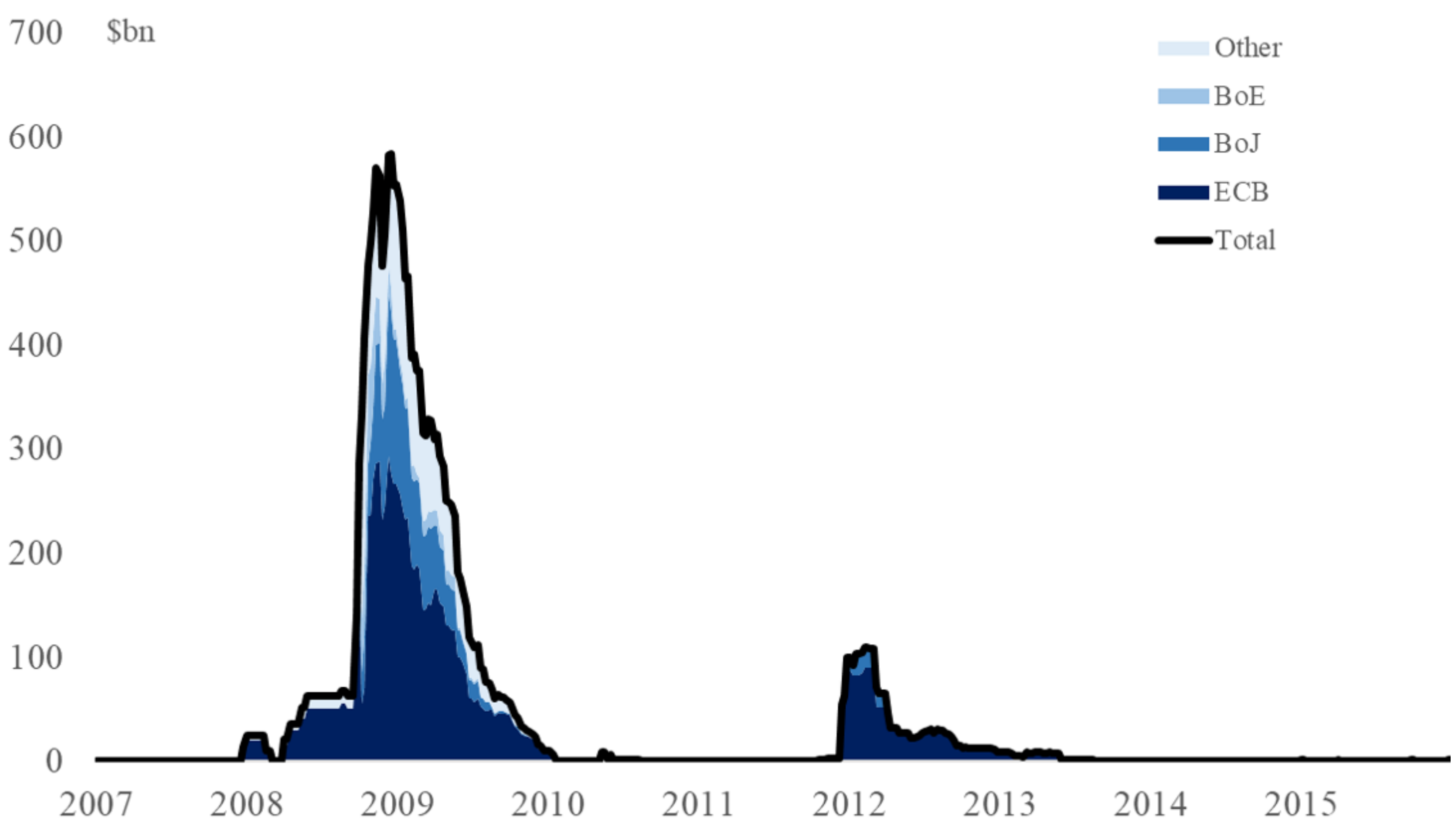
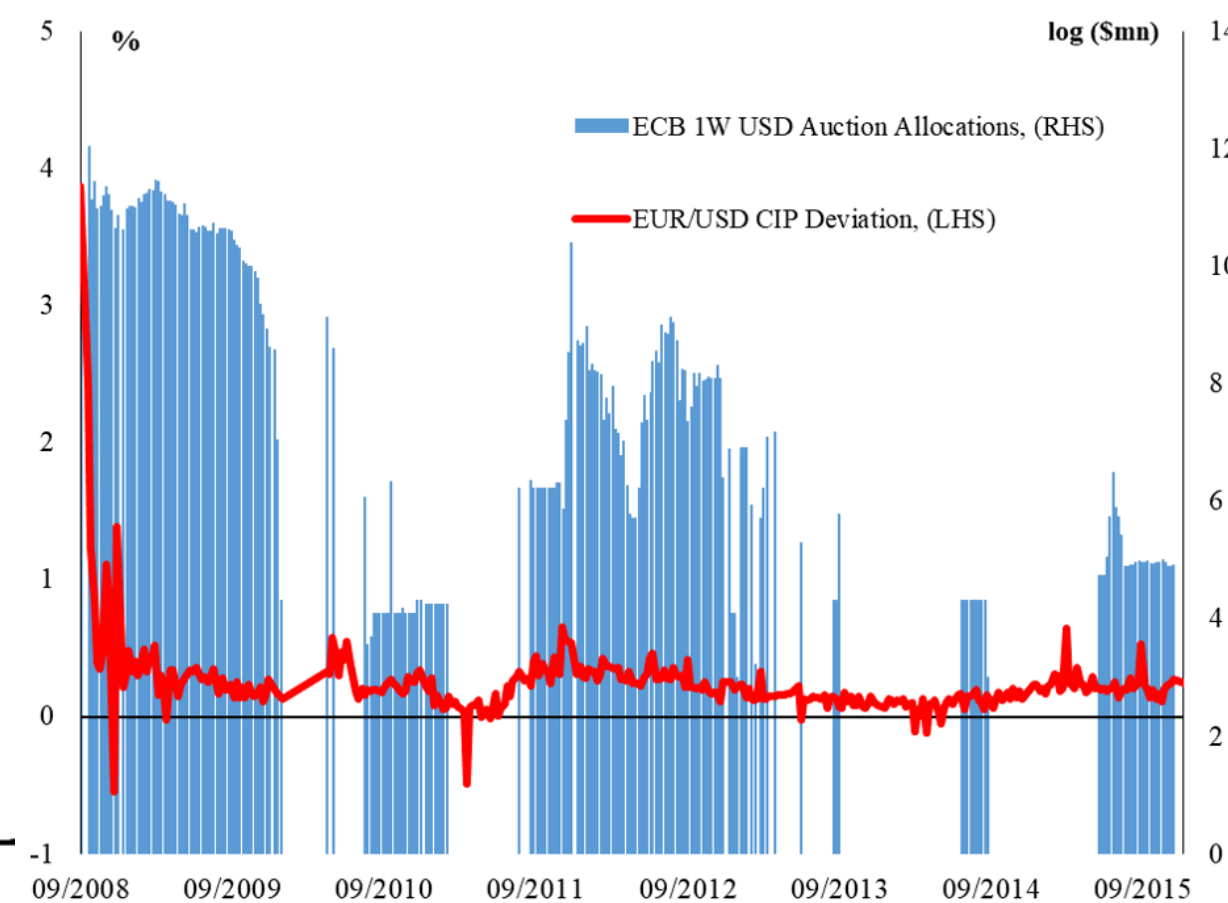
- **Why?** Income risk exposes "solvency", which is about fiscal support and independence.

- **How for ECB?** Take risk management seriously and as being about implicit fiscal support risk.

Liquidity / lending programs

- **Lessons:** Active discount window allows banks to keep more risk. With global banks need (i) foreign currency lending facility to domestic banks,





Source: Bahaj Reis (2018)

Liquidity / lending programs

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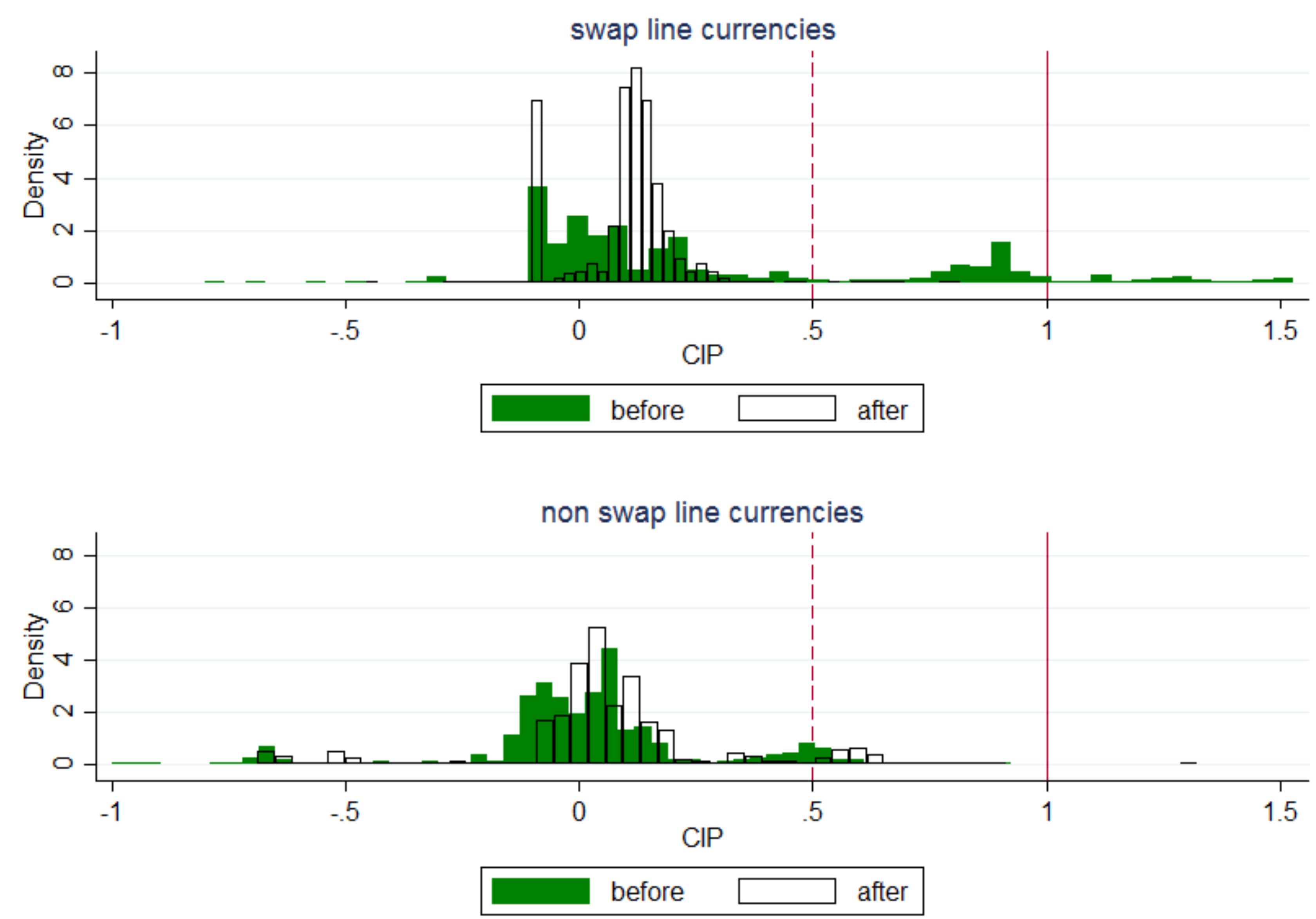

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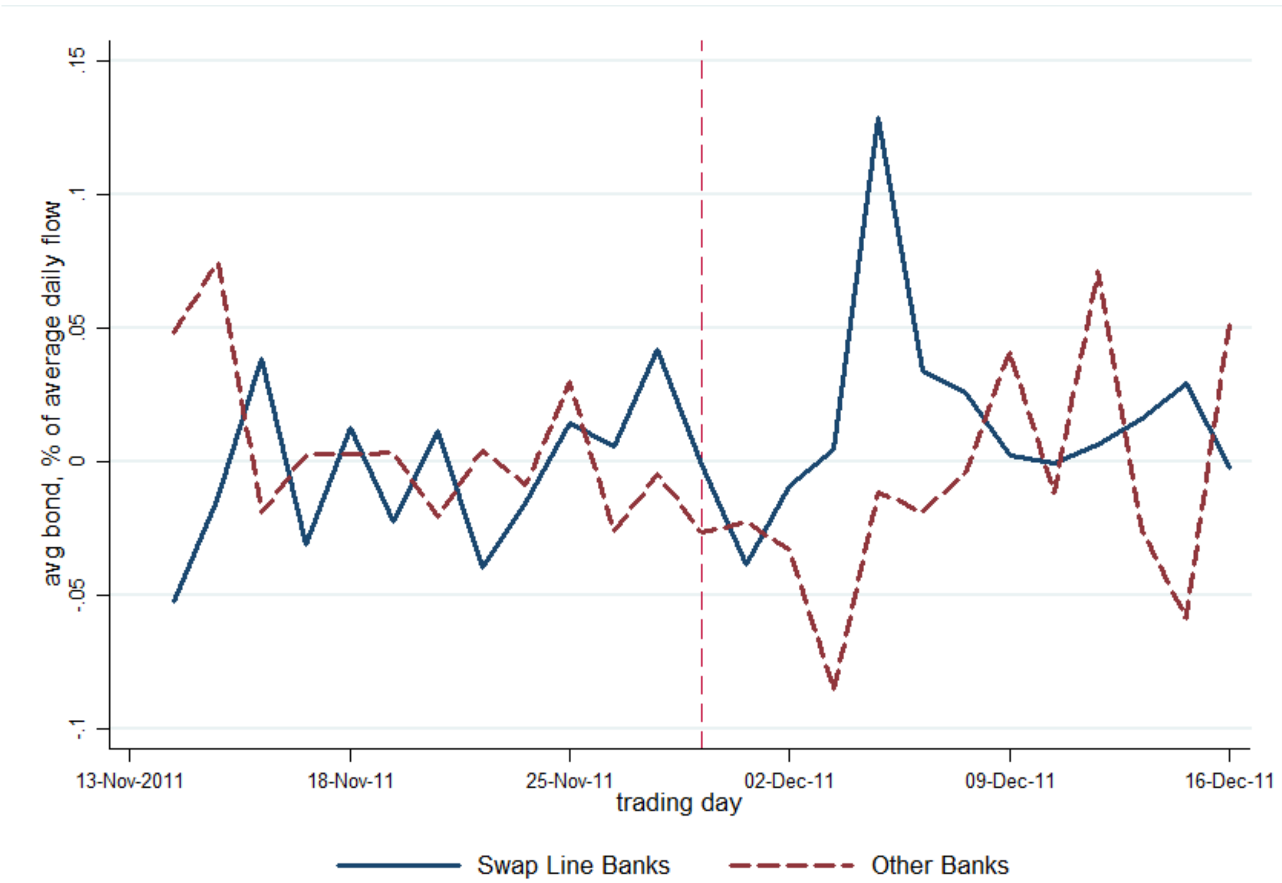
Liquidity / lending programs

- **Lessons:** Active discount window allows banks to keep more risk. With global banks need (i) foreign currency lending facility to domestic banks, (ii) put ceiling on funding costs of currency hedging, or (iii) domestic currency lending facility to foreign banks to stop fire sales of domestic assets.

Figure 7: Excess flows into USD bonds averaged across banks and bonds around the treatment date



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- **Why?** With global banks, need better rules and wider reach for the lender of last resort.

- **How for ECB?** Wide network, overcome bilateral, promote euro usage. Bank of England example

New normal balance sheet

Assets	Liabilities
Short-term safe bonds	Net worth / currency
Long-term risky bonds, risky assets (incl, foreign)	Bank reserves (deposits)
Lending programs	Extra reserves
	C.B. swap lines

Source: Reis (2019)