



EUROPEAN CENTRAL BANK

EUROSYSTEM

The ECB's recent non-conventional measures

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Lowering interest rates makes saving less attractive; induces investment and consumption. **Wicksellian arbitrage logic** provides basic idea:

$$\begin{aligned} \text{if } i_t < E(r_t) + E(\pi_t) & \Rightarrow \text{inflationary impulse} & \pi_t > E(\pi_t) \\ \text{if } i_t > E(r_t) + E(\pi_t) & \Rightarrow \text{disinflationary impulse} & \pi_t < E(\pi_t) \end{aligned}$$

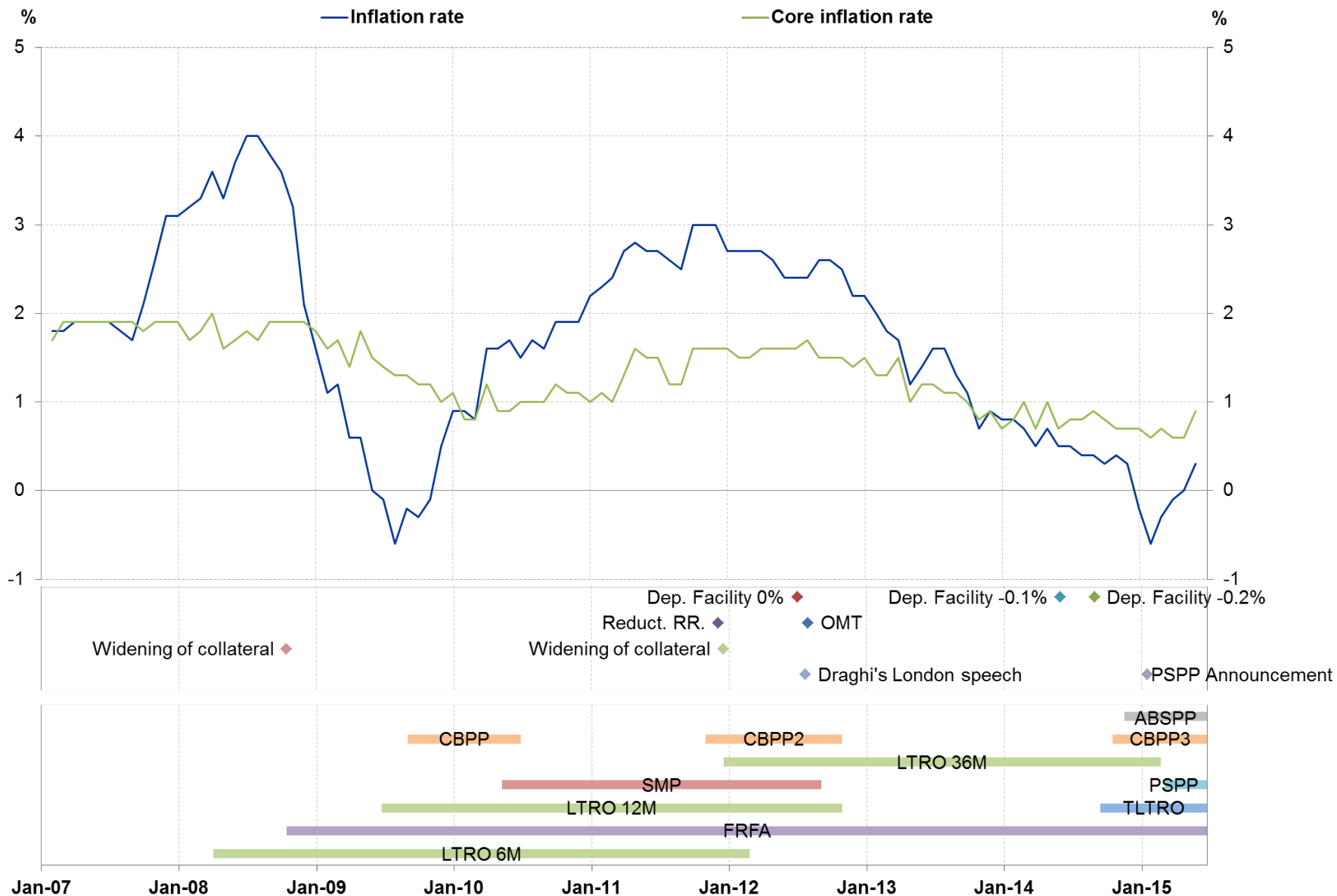
Importance of expected inflation rate (π) and real rate of return on capital (r).

Two further challenges:

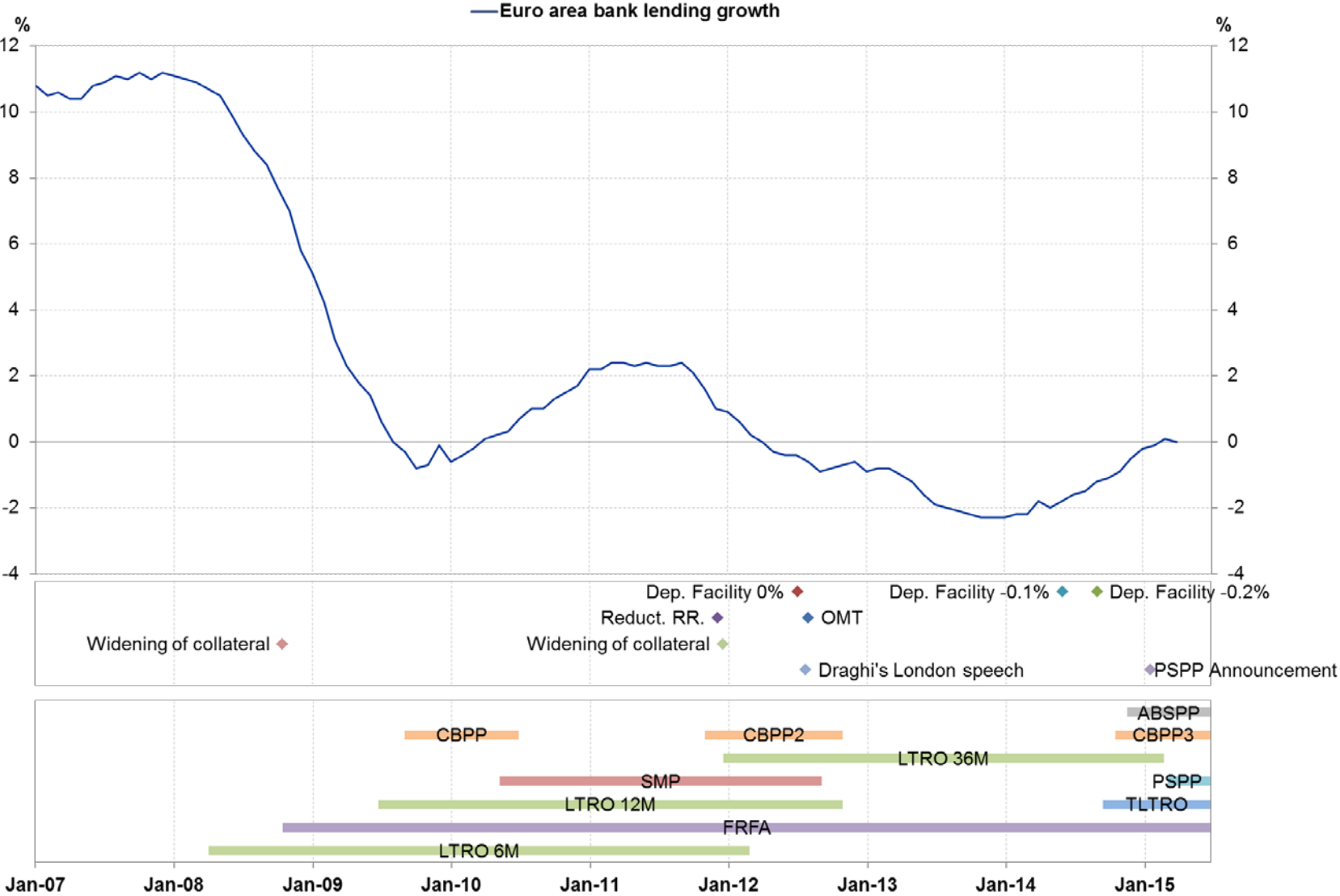
- (I) Term/credit/liquidity spread also affect firms' funding costs, and increase in financial crisis**
- (II) Zero lower bound problem** \Rightarrow ability to exert expansionary interest rate impulses can be exhausted \Rightarrow need to act forcefully, and in time.

Key role of unconventional monetary policies: compress spreads to reduce actual funding costs of the economy, thereby contribute to make monetary policy expansionary (prevent it to be contractionary)

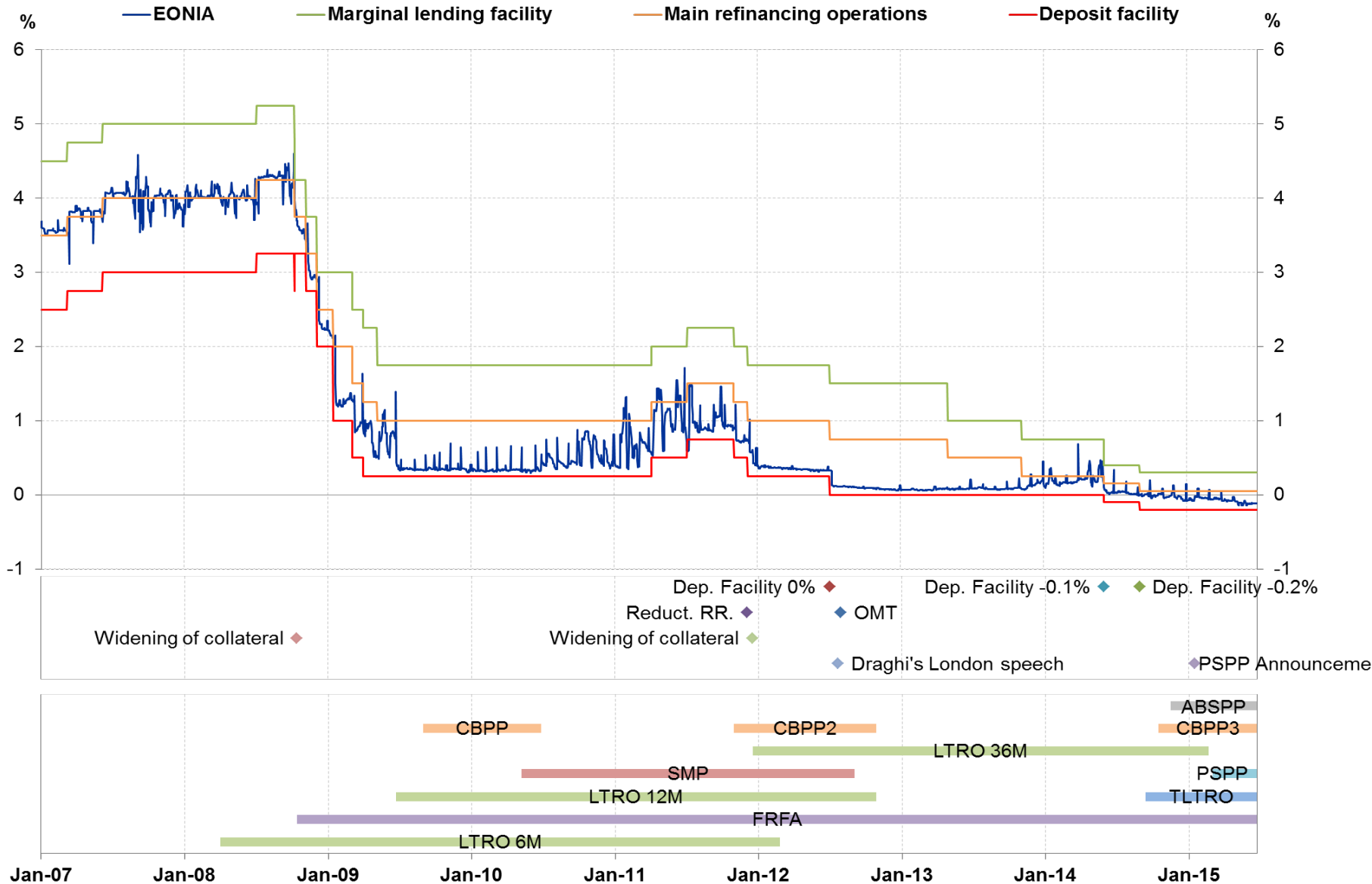
Euro area inflation rate from 01/01/2007 to 30/06/2015

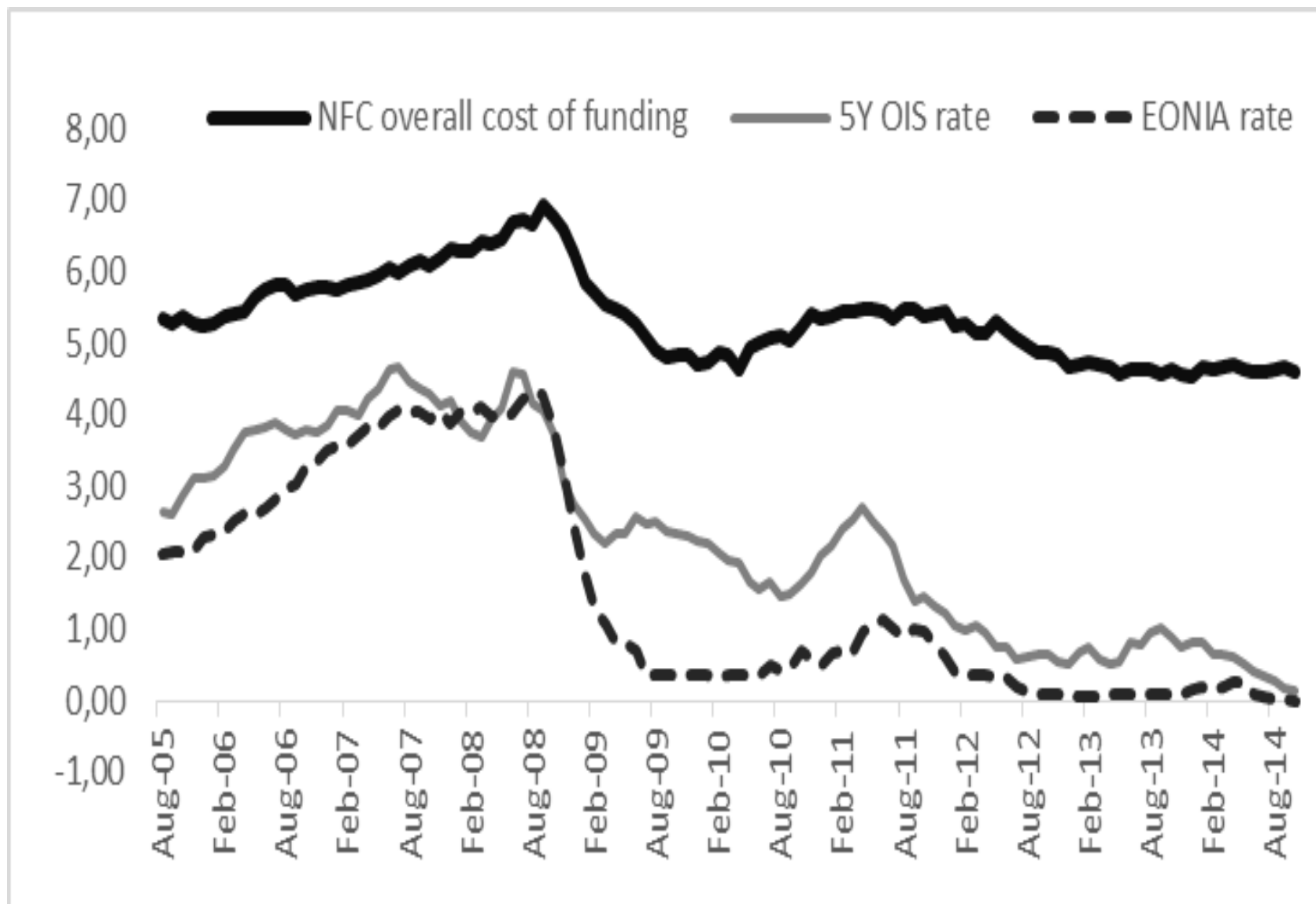


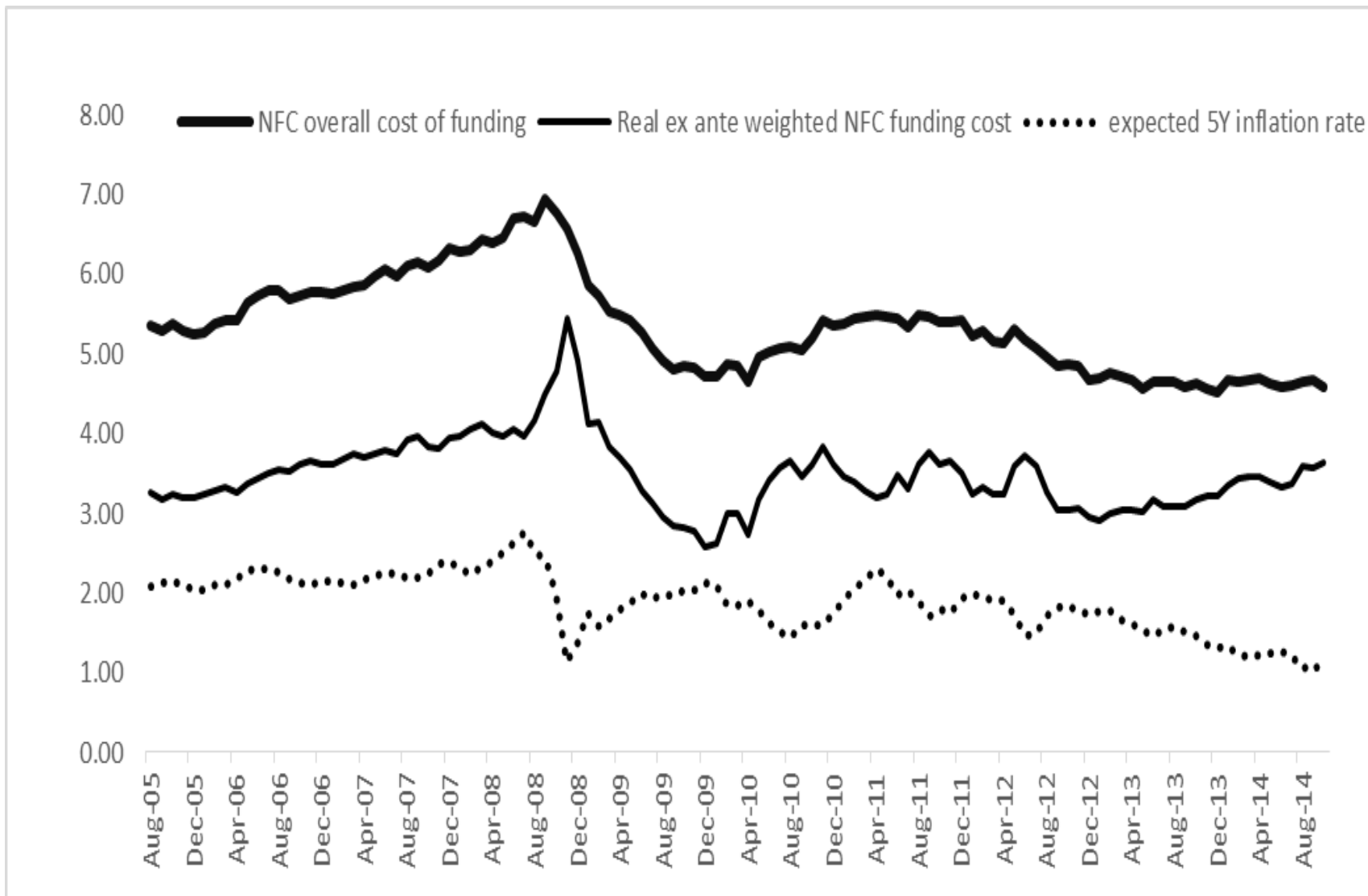
Euro area bank lending growth from 01/01/2007 to 30/06/2015

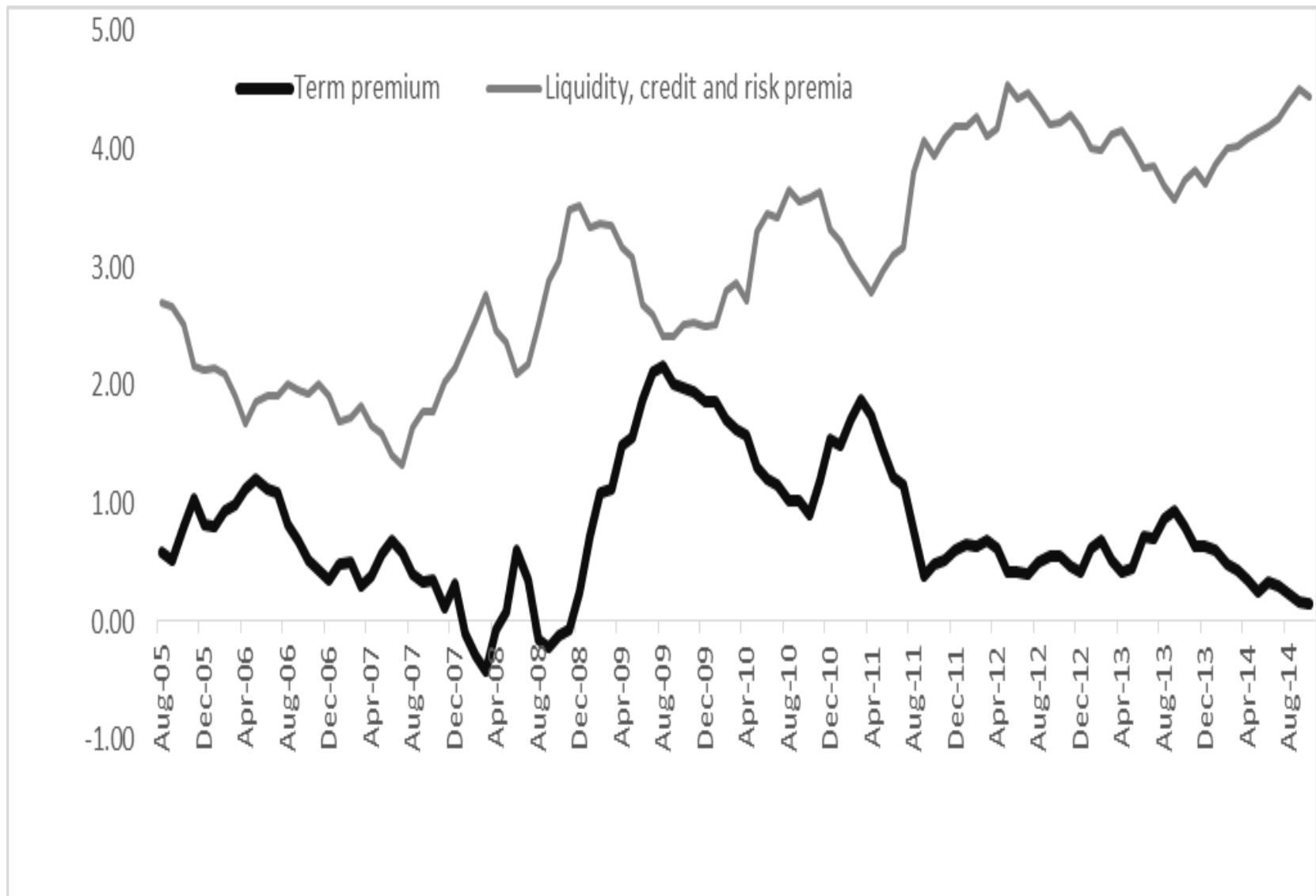


Central Bank rates and EONIA from 01/01/2007 to 30/06/2015

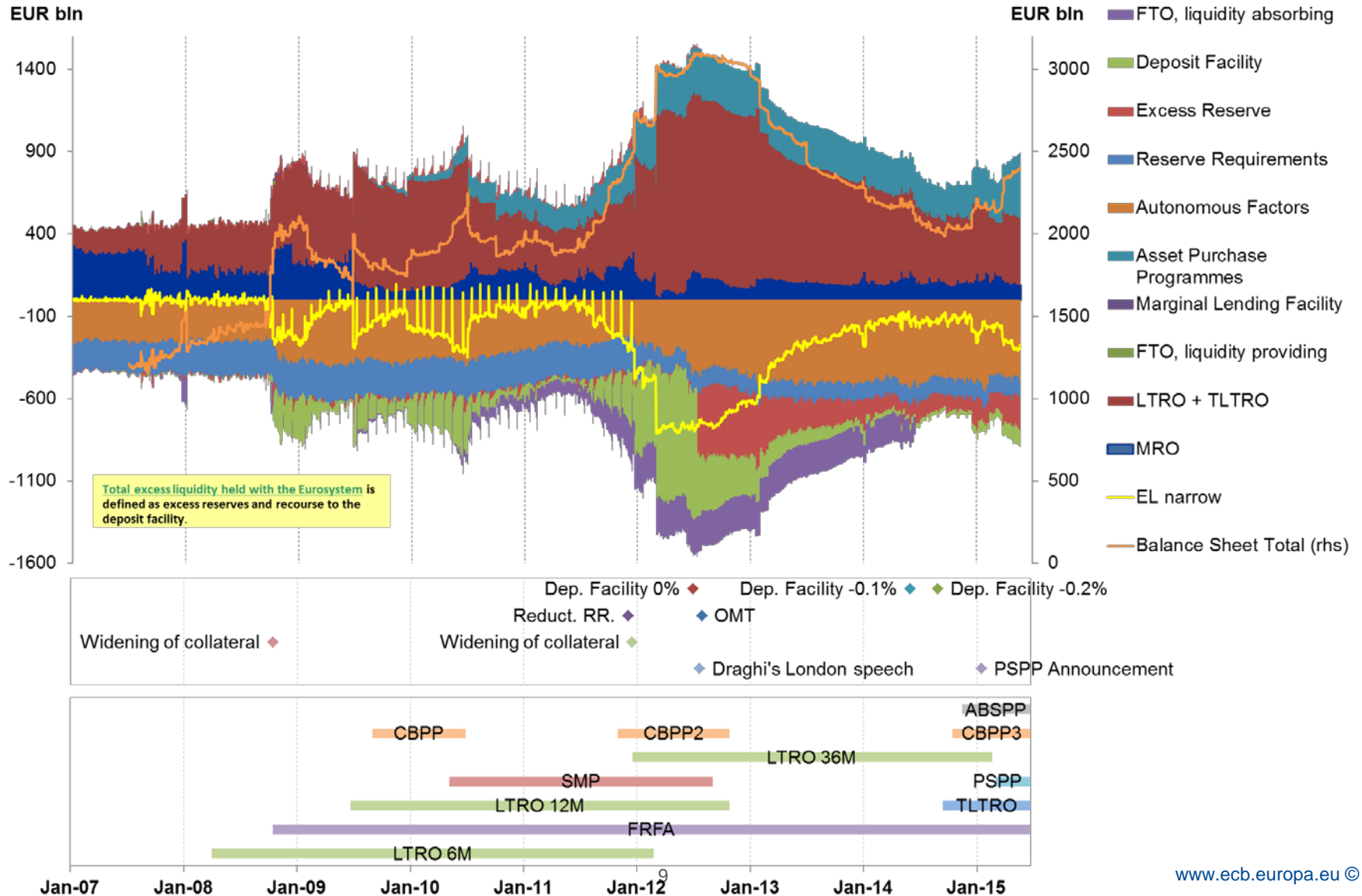








Size and composition of the cons. Eurosystem balance sheet Jan2007 to Jun2015



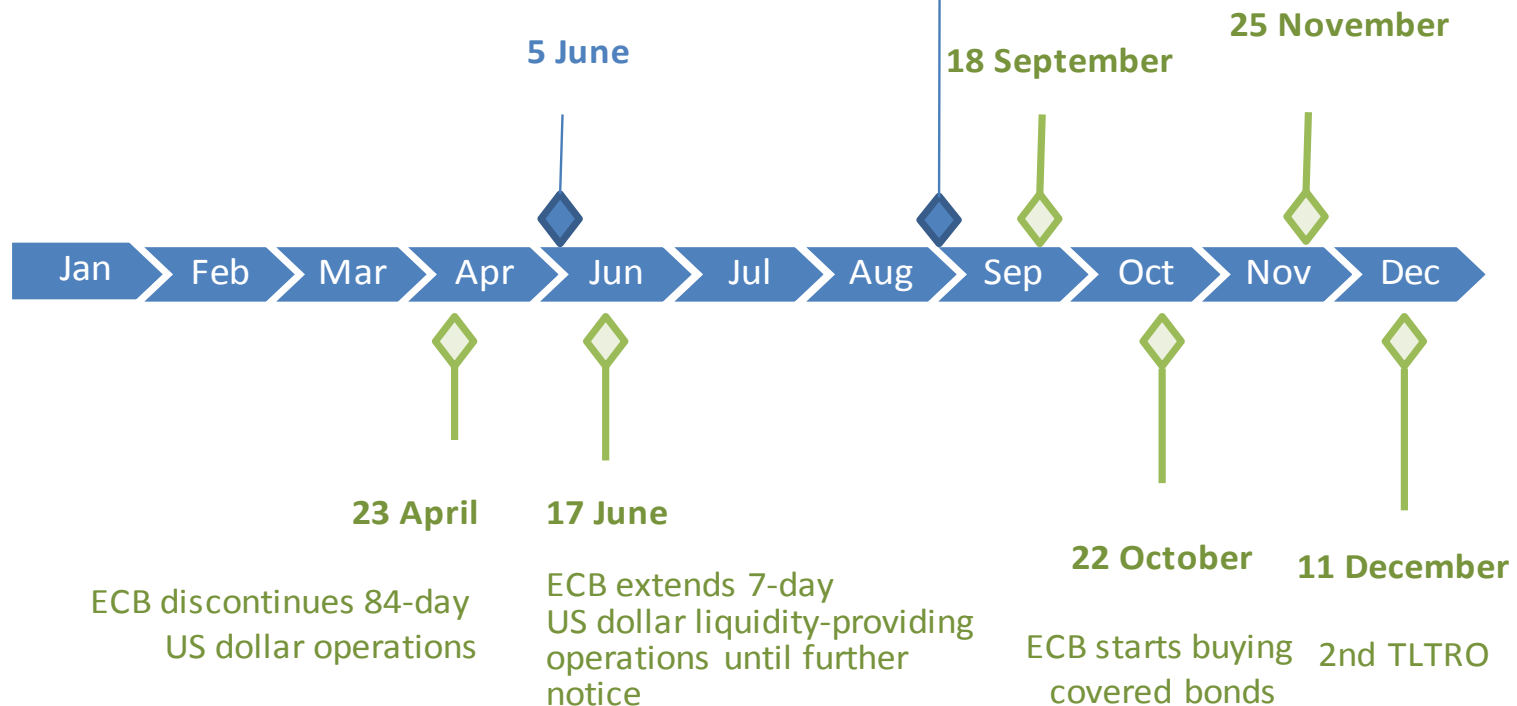
2014 monetary policy decisions on ECB standard and non-standard measures

ECB cuts rates (i.a. deposit facility to - 0.10%)
and prolongs fixed rate full allotment beyond
December 2016

ECB announces a series of Targeted LTROs
and suspends the weekly liquidity-
absorbing fine-tuning operation

ECB cuts rates
(i.a. deposit facility to - 0.20%)

ECB starts with the
Asset-Backed Securities
Purchase Programme



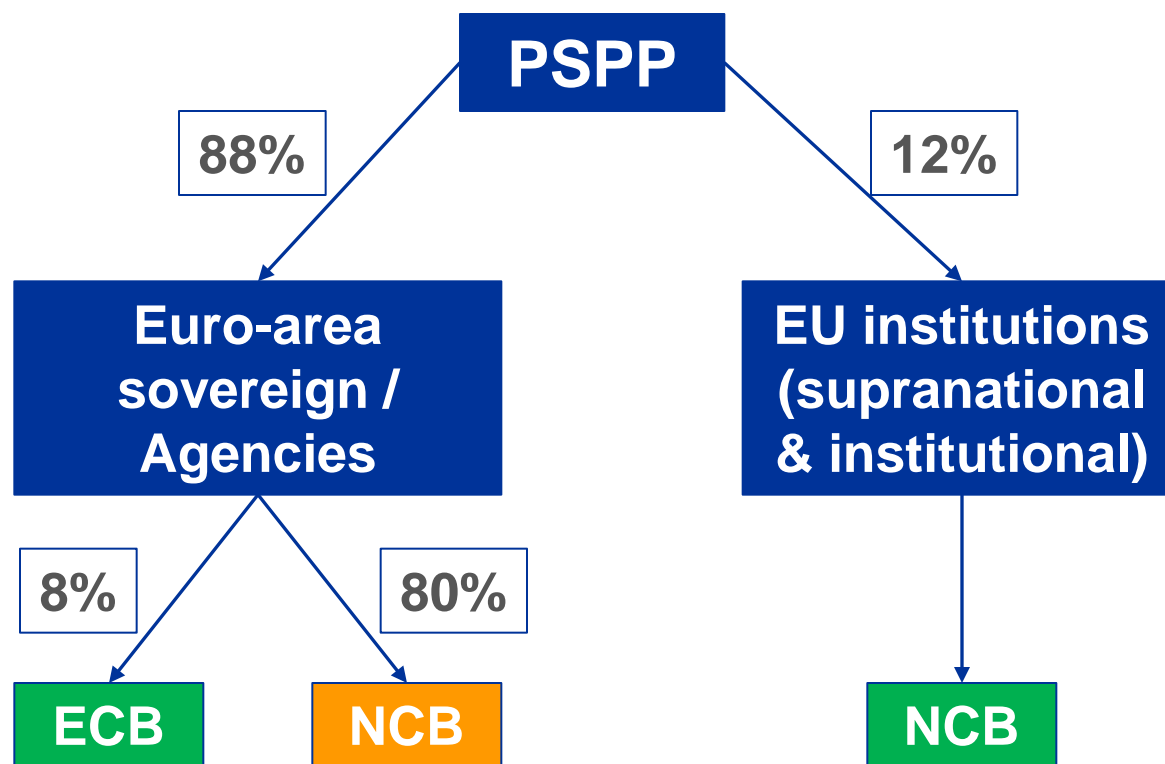
APP programme parameters – as announced in January 2015

	ABSPP	CBPP3	PSPP
Eligible Universe	Mon. pol eligible ABS (subject to DD assessment)	Mon. pol eligible CBs for own use & multi-cedulas	Mon. pol. eligible central government bonds, agencies and EU supranationals
Minimum rating	CQS3	CQS3	CQS3
Maturity	All	All	2-30 years
Issue Limit	70%*	70%*/**	25%*/**
Issuer limit	No	Yes**	33%**
Purchases	1 ^{ary} & 2 ^{ary} market	1 ^{ary} & 2 ^{ary} market	2 ^{ary} market (ensuring market price formation)
Implementation	4 EAMs and 1 IAM	Decentralised	Decentralised
Securities Lending	Yes	Yes	Yes

* Specific conditions for programme countries apply

** Combined Eurosystem holdings from monetary policy and investment portfolios

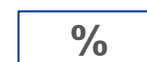
Public Sector Purchase Programme (PSPP)



Loss-sharing



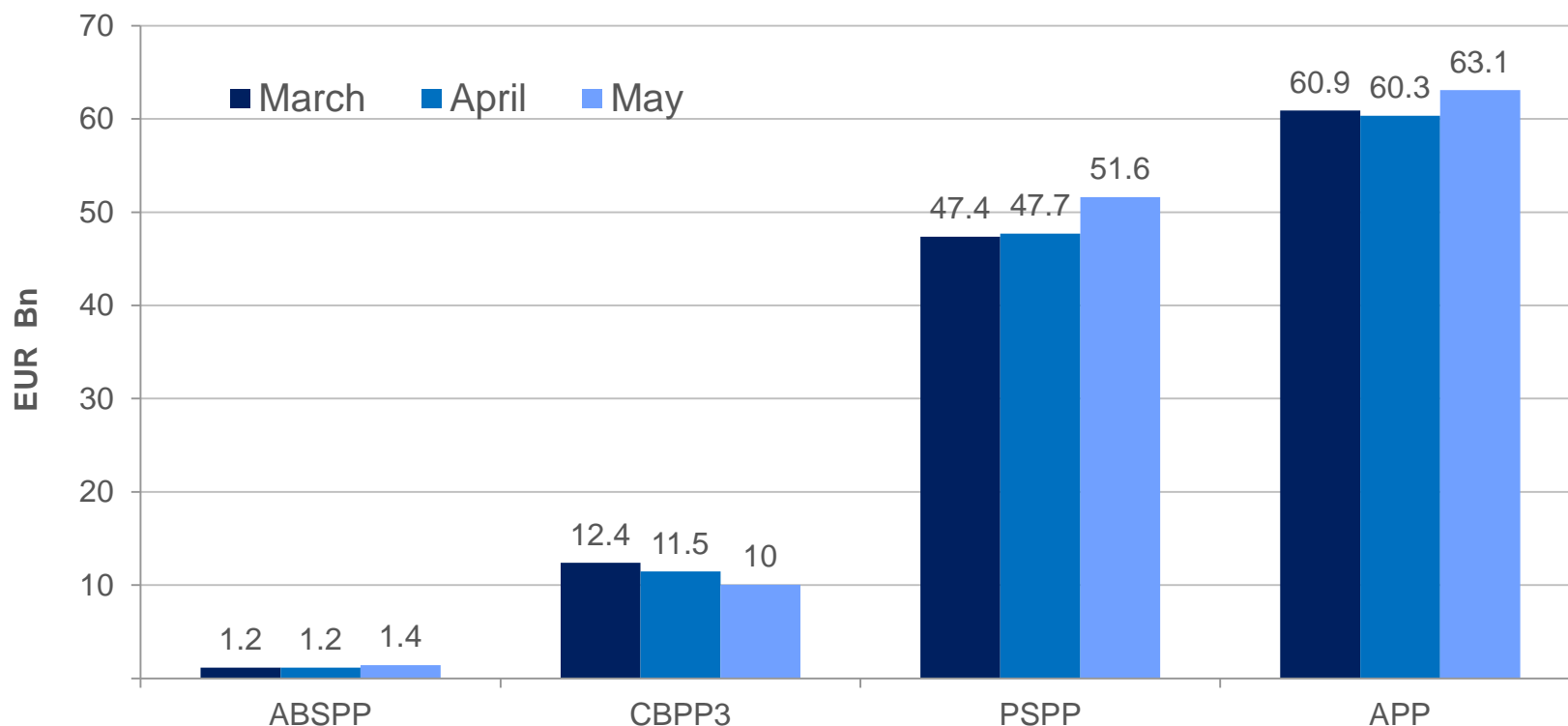
Non loss-sharing



% Proportion of purchases

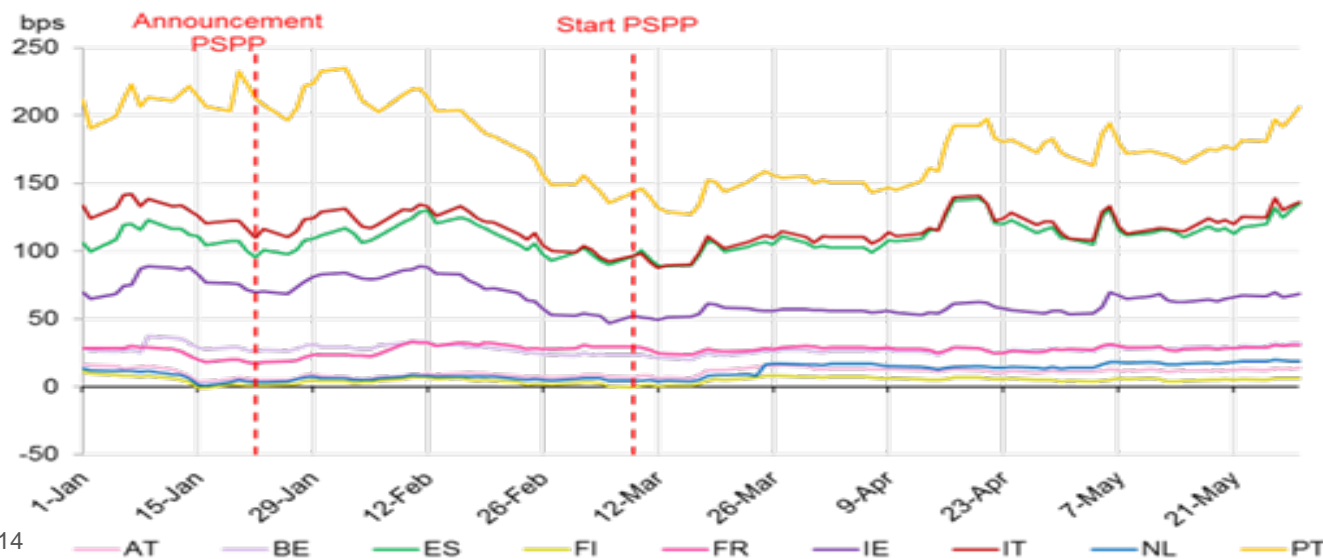
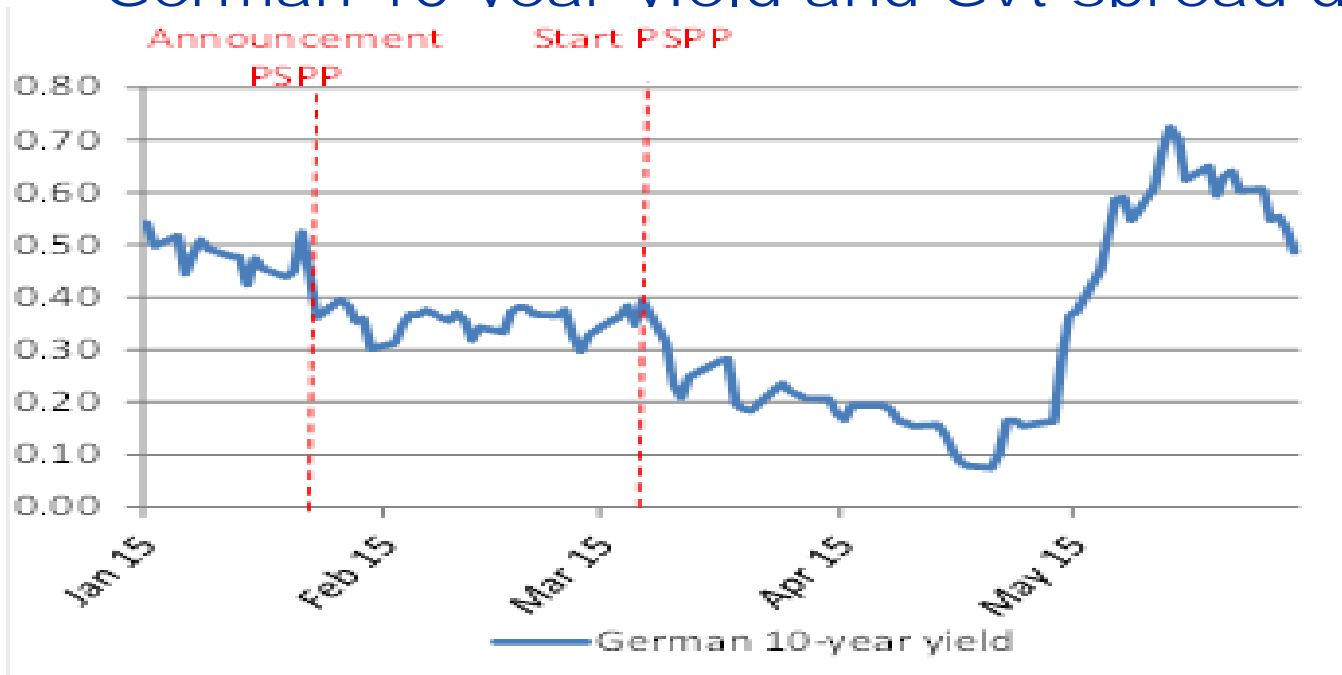
Combined monthly purchases of EUR 60 bn

Settled purchases (March - May 2015)
(at amortised cost)



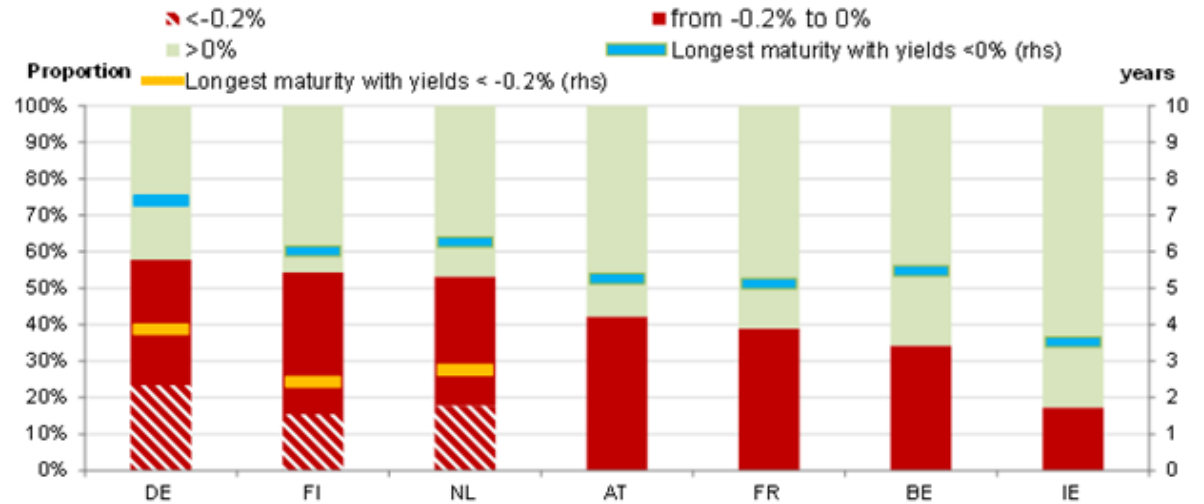
Source: ECB website

German 10 year yield and Gvt spread developments

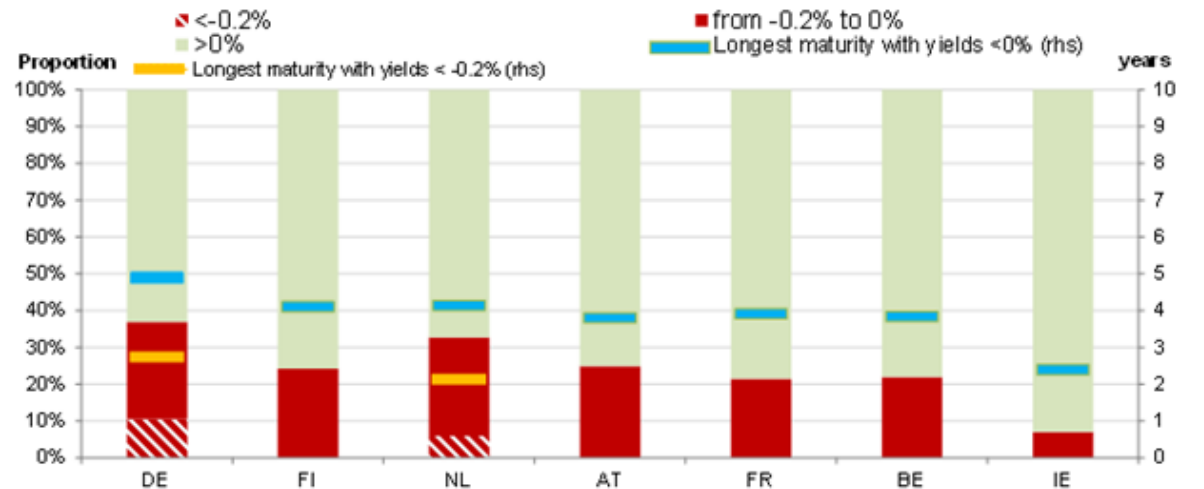


Share of PSPP eligible bonds with yields below zero or below deposit facility

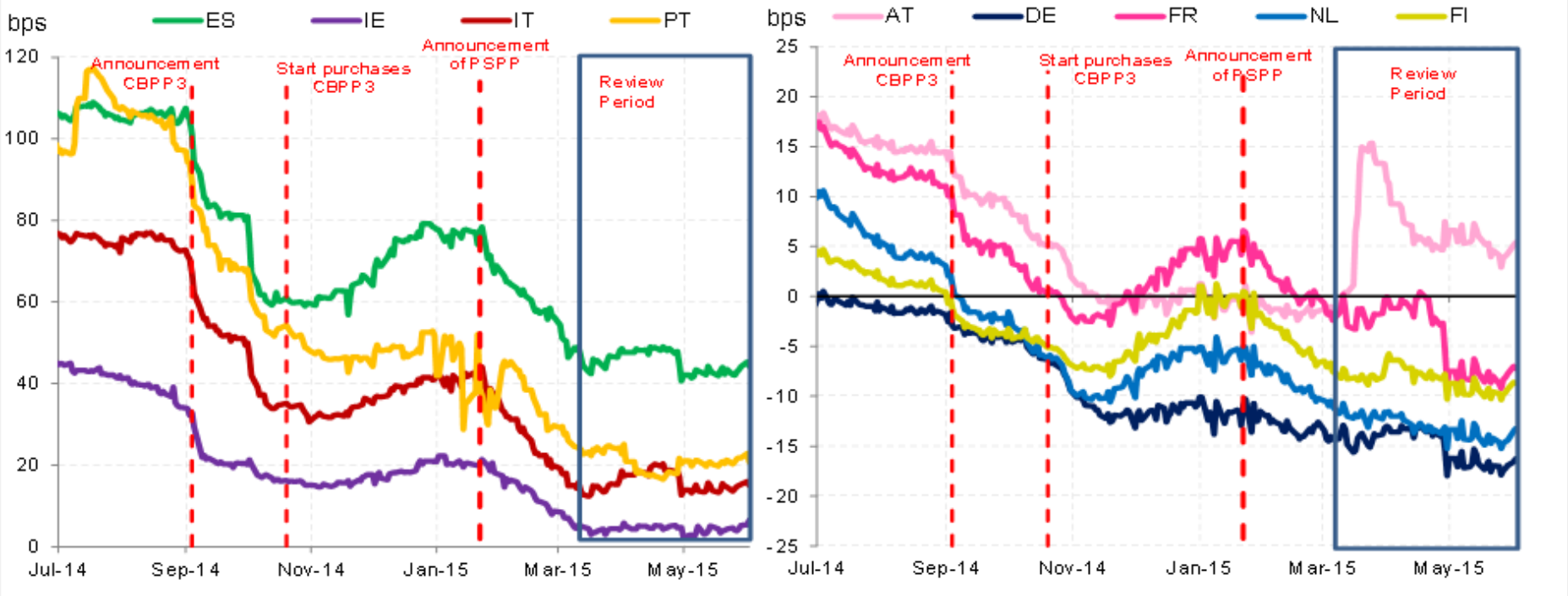
As of 15/04/2015



As of 29/05/2015

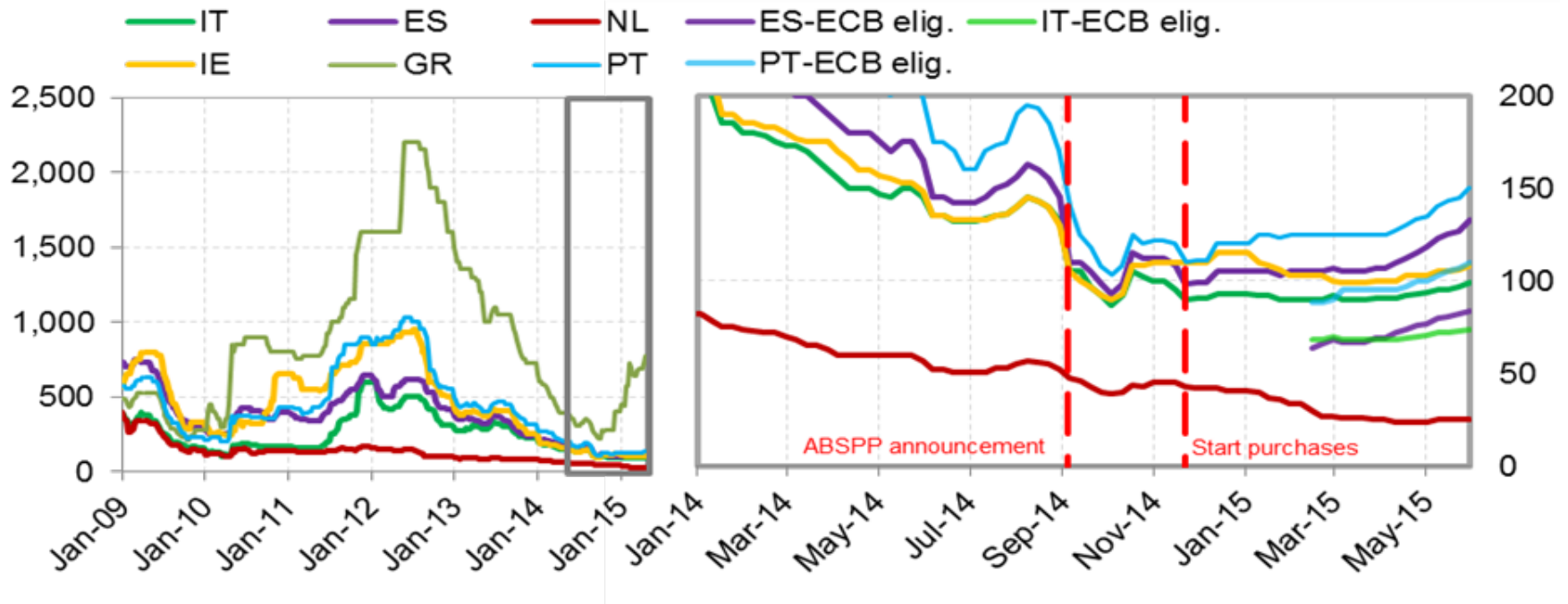


Covered bond asset swap spreads



Source: ECB website

ABS: AAA-rated floating rate RMBS 5-7 years maturity



Source: ECB website

Key Considerations for PSPP implementation with regard to market liquidity

- The implementation of the PSPP aims **ex ante at market neutrality** in the sense of avoiding dislocations in euro area government bond curves within the agreed maturity range of 2 to 30 years.
- Preservation of market liquidity can be considered as a prerequisite for the proper working of the portfolio rebalancing channel.
- Avoid, to the extent possible, purchasing current cheapest-to-deliver bonds, securities commanding “special” rates in the repo market, and other assets displaying significant liquidity shortages.
- Purchases conducted in small ticket sizes, across the yield curve, across the day and across types of eligible bonds.

ECB PSPP securities lending activities so far

Main parameters of the ECB lending facility

Implementation	Deutsche Bank AG as lending agent
Fee	Week 1: 40 bps vs. GC; Week 2: 50 bps vs. GC; Week 3: 60 bps vs. GC; Week 4: 70 bps vs. GC
Counterparties	Targeting primary dealers and other market makers; currently 22 set up
Collateral accepted	All trades must be cash neutral. Collateral: full range of PSPP-eligible securities (+ < 2yr bonds)
Haircut	4 % on the reverse repo leg
Limit per counterparty per ISIN	Max 2.5% or €200mn of issue (the smaller of the two)
Other limits	Ticket size max. €50mn; counterparty limits in place etc.

More information about the ECB's arrangements [on the ECB website](#)

- The ECB launched its PSPP SL on 2 April 2015
- The holdings under the SMP are also made available
- Intended as a backstop facility
- The facility has seen some genuine borrowing interest
- Deutsche has received a lot of interest from market participants
- ECB also participates in the fails mitigation lending programme SLB by Euroclear

PSPP securities lending framework and implementation status

- As of 2 April 2015, a number of Eurosystem central banks went live with PSPP SL
- Common high level principles within the Eurosystem on
 1. lending channels
 2. cash neutrality
 3. discretion to determine lending modalities so as to support market liquidity
 4. monitoring activities to ensure effectiveness
- Information on the general PSPP securities lending framework can be found [on the ECB website](#)

Central bank	Bilateral	Agency	ICSD opportunity lending	Fails mitigation
ECB	-	yes	-	yes
AT	-	-	-	-
BE	yes	-	-	_*
CY	-	-	-	-
DE	-	-	-	yes
EE	yes	-	-	-
ES	yes	-	-	yes
FI	yes	-	-	yes
FR	yes	-	-	yes
GR	-	-	-	yes
IE	-	-	-	yes
IT	-	-	yes	yes
LT	-	-	-	yes
LU	-	-	-	-
LV	-	-	-	-
MT	yes	-	-	-
NL	yes	-	-	yes
PT	-	-	yes	yes
SI	-	-	-	yes
SK	-	-	-	yes

Source: ECB, national central bank websites

Liquidity in euro area government bond markets

(measure: weighted yield difference between the first and second price offer we got for a security which we purchased)

Group 1

Group 2

small

Austria, Belgium, Finland, France,
Germany, Netherlands

Ireland, Italy, Portugal, Spain

Latvia, Lithuania, Luxembourg, Malta,
Slovakia, Slovenia

Conclusion on APP programme

- Forceful monetary accommodation in a zero lower bound context
- Assessment of success using the three key target concepts:
 - Operational targets fully reached
 - Intermediate targets have behaved to some extent volatile, but difficult to draw conclusions from this
 - Ultimate target has moved in the right direction since launch of the new measures
- Looking forward, market liquidity issues and hence possibly volatility will certainly remain important, in particular in the context of several factors that have anyway tended to reduce market liquidity